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"DIRECTORS' DUTY OF CANDOR: EASY TO SAY, HARD TO COMPLY"

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ARTICLE: Calling Off the Lynch Mob: The Corporate Director's Fiduciary Disclosure Duty

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SUMMARY:
... The Fiduciary Disclosure Duty Identified ... Thus, a fiduciary duty of disclosure was identified in cases where a director relied upon stockholder ratification of a self-dealing transaction, or, as in Lynch itself, where the fiduciary's knowledge of favorable but confidential corporate information permitted the fiduciary to acquire stock from a minority or outside stockholder at an unfairly low price. ... Properly understood, Lynch did not create a fiduciary duty of disclosure of universal application, requiring directors to disclose material corporate information in any and all contexts in which such disclosure might affect stockholder action. ... It might be argued, after all, even acknowledging director disinterest and due care, that a failure to disclose a material fact, as required by the fiduciary recommendation disclosure duty, cannot go unremedied simply because that failure is only identified by the court after it has become too late to grant preliminary injunctive relief or rescission. ...

TEXT:
[*1087] [*1088] [*1089]

I. Introduction

A. The Fiduciary Disclosure Duty Identified

Two parallel bodies of American law establish the obligations of corporate directors to disclose information about the corporation to its existing stockholders: (1) the Securities Exchange Act of 1934, n1 [*1090] and (2) state common law, including doctrines such as fraud and negligent misrepresentation. n2 Although these state common law doctrines have been applied to transactions in corporate securities, their significance has been largely eclipsed by comprehensive federal regulation. n3

Of growing importance, however, is a state law duty that courts have created and imposed upon directors based upon their fiduciary relation to the corporation and its stockholders. In the last twenty years, this branch of fiduciary doctrine has blossomed prolifically, particularly in the Delaware state courts. n4 According to the Delaware Supreme Court in Stroud v. Grace, n5 it is now "well-recognized" that fiduciary duty requires directors to disclose all material [*1091] information within their control when they seek stockholder action. n6 Just thirteen days after the Stroud opinion was issued, moreover, a Delaware trial court went further, holding that a fiduciary duty to disclose all material information arises when directors approve any public statement, such as a press release, regardless of whether any specific stockholder action is sought. n7

As described in the Delaware cases, this fiduciary disclosure duty is deep, as well as broad. The duty is said to be strict, imposing liability without regard to director negligence or other culpability; n8 to afford stockholders a remedy without regard to whether they relied upon a statement made in violation of the duty; n9 and to afford a "virtual per se rule" of damages, under which stockholders may obtain a monetary award on account of a breach of the disclosure duty without having to establish actual loss. n10

B. The Breadth of the Doctrine Illustrated

Consider where the foregoing articulation of the fiduciary disclosure duty would lead in the following hypothetical case: Directors of a Delaware corporation solicit proxies in support of a proposed merger in which the stockholders receive cash for their stock at a substantial premium over the prevailing market price. The merger is entirely at arm's length. There is no overlap of stock ownership between the acquiror and the target. Only a small minority of the target's board of directors are officers, and none of those officers receives either assurances of future employment, or any consulting contract or other special consideration in the merger. The sale process is impeccable, and the stockholders and the financial community universally accept the sale price as the highest reasonably available. [*1092] In short, there is no plausible claim of breach of any fiduciary duty to obtain the highest reasonably available price. n11

With one possible exception, the process by which proxies are solicited from the stockholders is likewise impeccable. The directors take pains to assure that management, aided by experienced securities counsel, allows ample opportunity for review of the proxy statement. The directors themselves review late drafts of the proxy statement and supply helpful clarifications. n12 One disclosure point is reviewed in particular in a board meeting. After considerable discussion, counsel advises the directors that the proxy statement need not disclose year-old internal revenue and earnings projections for a division which has accounted for about twenty-five percent of sales and income. Having somehow learned of those projections, however, a former stockholder brings a class action against the former directors. The former stockholder seeks declaratory and injunctive relief, as well as rescission and damages, on the theory that the directors violated their fiduciary duty of disclosure by not including the projections in the proxy statement.

The directors move for summary judgment, and the court's analysis of applicable fiduciary duty principles begins with the observation that the directors were soliciting proxies when they presented the merger proposal to the stockholders for approval. Hence, under what has become black letter doctrine, the fiduciary duty of disclosure required the directors to disclose all facts within their control that were material to the merger proposal. n13 The court concludes that the projections could be material information, since a reasonable investor [*1093] could have considered their disclosure a significant change in the "total mix" of available information. n14

The defendant directors press their summary judgment motion, however, on three further points. First, the directors claim exoneration by reason of lack of evidence of negligence, let alone scienter, on their part. They point out that even under federal law, where congressional policy mandates full disclosure in the solicitation of proxies, n15 damages liability depends upon proof of negligence. n16 Therefore, they argue, there is no reason why any state common law policy of disclosure to stockholders n17 should be more exacting.

Second, the directors dispute that any stockholder actually relied on the nondisclosure of the projections, and have offered impressive proof that the merger vote would have been unaffected even if the projections had been disclosed. Finally, the directors maintain that no damages can be established. Specifically having failed to question the sufficiency of the process by which the company was sold, plaintiff cannot establish that the stockholders received anything less than full and fair value for their shares.

Adopting statements from the Delaware cases, however, the court rejects these three contentions summarily. Addressing first the plea of due care and good faith, the court cites a plethora of Delaware cases identifying a fiduciary duty to disclose material facts, and notes that none of those cases indicates that this duty can be breached only by a culpable failure to disclose. n18 The court also notes, quoting Chancellor William T. Allen in In re Anderson, Clayton Shareholders' [*1094] Litigation, n19 that "the question whether shareholders have, under the circumstances, been provided with appropriate information upon which an informed choice on a matter of fundamental corporate importance may be made, is not a decision concerning the management of business and affairs of the enterprise" n20 and therefore is not a matter on which the due care and good faith of the directors can, as under the business judgment rule applicable to management decisions, carry the day for the defendants. n21 Citing scholarly comment, n22 the court disavows any culpability requirement by observing that a transaction should not be allowed to go forward where stockholder approval is being obtained on the basis of materially incorrect or incomplete information simply because the directors reasonably, but incorrectly, believed in the sufficiency of the information. n23

The directors' second and third defenses fall more easily. The court rebuffs their attempt to disprove reliance, reciting the Delaware [*1095] Supreme Court's terse rejection of the argument: "Delaware law is settled that there is no reliance requirement in a claim for breach of a fiduciary duty of disclosure." n24 With equal dispatch, the court passes over the absence of proof of actual damages, quoting a Delaware Supreme Court ruling that "in Delaware existing law and policy have evolved into a virtual per se rule of damages for breach of the fiduciary duty of disclosure." n25

In short, by a plausible, and arguably mandatory, reading of Delaware case law, a court may be obliged to require directors to pay damages on account of a failure to disclose what is determined in hindsight to have been a material fact in connection with a transaction in which the directors had no self-interest and acted with the utmost good faith and due care. Further, no stockholder could establish either reliance on the nondisclosure or damage resulting from the merger accomplished by means of the deficient proxy statement.

One may be skeptical that a court would follow the language of the Delaware cases to this logical end, since monetary liability even for the negligent action of disinterested directors is rare and disfavored by the law. n26 As logically as the result would seem to follow from the case law, holding the disinterested directors personally liable in damages for a nondisclosure, regarding which they reasonably relied on advice of counsel, would seem difficult to reconcile with statutes which purport to protect reasonable director reliance upon the advice of experts such as securities counsel. n27

Nevertheless, since the broad articulation of fiduciary disclosure duty in the recent Delaware cases potentially implies director liability in the hypothetical case described above--liability that is inconsistent with customary notions of the limits of such liability--it is worthwhile to reassess the evolution of the case law in order to supply a more logical and predictable framework for future cases. Such a reassessment of the doctrinal foundations of the fiduciary duty of disclosure, moreover, clarifies a potentially critical uncertainty under present case law. So long as the courts characterize the director's fiduciary disclosure duty as an ill-defined hybrid of the duties of [*1096] care and loyalty, n28 directors and corporate counsel will be uncertain as to whether exculpatory provisions in the certificate of incorporation can effectively limit or eliminate damages liability for breach of that fiduciary disclosure duty. n29

C. How Did We Get Here, and Where Do We Go From Here?

The evolution of judicial treatment of the director's fiduciary disclosure duty has received little systematic attention. Scholarly comment directly addressing this emerging state law concept is not extensive. n30 In two brushes with the matter, the American Law Institute first avoided altogether an attempt to define the concept, n31 and later dealt with the concept only as a facet of the duty of loyalty. n32 Much of the sparse scholarly commentary is devoted to cataloguing how the courts have assessed the materiality of various kinds of information. n33 To the limited extent that these commentators have [*1097] attempted to identify the source of the directors' fiduciary disclosure duty, they have tended to describe it as the courts have: in a unitary fashion, in which the character of the duty--to whom it is owed, when it is owed, and the remedies for its breach--is the same in whatever context it arises. n34 Tracking the broad language of recent Delaware case law, they have characterized this fiduciary duty, in generalized terms, as a "duty of candor," n35 or, more recently, as a fiduciary "duty of disclosure." n36

This approach, however, suffers from the same defect that has characterized the courts' development of the law: an unsurprising but often uncritical tendency to follow elevated moral rhetoric, which the courts use to describe the director's fiduciary duties, into contexts in which such rhetoric was never intended to apply. n37 Thus, in the years [*1098] after a leading Delaware Supreme Court opinion, Lynch v. Vickers Energy Corp., n38 described a fiduciary duty of "complete candor," of "complete frankness ... [under which c]ompletenesss, not adequacy, is both the norm and the mandate," n39 the courts naturally latched onto that language to identify a fiduciary disclosure duty in a variety of contexts strikingly different from the self-dealing context addressed in Lynch. n40

This Article argues that this progression in the recent Delaware cases represents an overreaction by the corporate bench and bar to the force of the fiduciary rhetoric in Lynch and its progeny. n41 Hence the title of this article, suggestive of the psychological phenomenon in which a group, stirred by collective moral fervor and indignation, attempts, without due deliberation, to mete out sanctions in circumstances in which such sanctions are truly not deserved or appropriate. n42

A measured approach to determining the appropriate scope and character of the director's fiduciary duty of disclosure first requires a recognition that fiduciary relations are too diverse and complex to permit identification of a singular, uniform disclosure duty having the same content in all contexts. To sharpen the definition of the fiduciary duty of disclosure, this Article proceeds in three steps. The first step is to examine two legal sources to which the fiduciary disclosure duty has sometimes been traced: a repealed Delaware [*1099] statute prescribing director and officer liability for false statements concerning the corporation; n43 and older case law identifying a state law obligation to disclose material facts in the solicitation of proxies. n44 Admittedly this first step fails to advance the analysis. The Article concludes that neither of the legal areas examined is appropriately identified as a source of the director's fiduciary duty of disclosure.

The second, and more productive, step is to examine the judicial opinions which directly articulate and apply concepts of fiduciary duty to require disclosure by corporate directors. This examination reveals the extent to which the courts have recently extended the fiduciary disclosure duty beyond the contexts in which such a duty had traditionally been identified. Before Lynch, the fiduciary disclosure duty of directors had been limited to situations in which the directors' personal financial interest conflicted with that of the corporation and the stockholders generally. Thus, a fiduciary duty of disclosure was identified in cases where a director relied upon stockholder ratification of a self-dealing transaction, n45 or, as in Lynch itself, where the fiduciary's knowledge of favorable but confidential corporate information permitted the fiduciary to acquire stock from a minority or outside stockholder at an unfairly low price. n46 In Smith v. Van Gorkom, however, the Delaware Supreme Court established that failure to disclose material information to stockholders could expose a director to liability for breach of fiduciary duty even in the entirely distinct context in which the director is disinterested. n47

This Article concludes that much of the judicial development of the fiduciary duty of disclosure can be placed on a theoretical and precedential footing that reinforces the legitimacy of that law. That firm footing can ultimately be found, however, only by taking a third analytical step; that is, by identifying the principles that define generally when a fiduciary relationship arises, ascertaining the disclosure duties such relationships engender, and determining the remedies appropriate for breach of each disclosure duty. n48 [*1100]

D. Fundamental Fiduciary Principles: A Preview

Because it highlights the very distinct contexts in which fiduciary duties may arise, the exercise of identifying basic principles of fiduciary duty helps delineate the directors' fiduciary duty of disclosure. For example, one form of fiduciary disclosure duty is a corollary of the traditional fiduciary duty of loyalty. That traditional fiduciary principle applies where a person who is empowered to manage the property of others for their benefit uses such property for personal benefit. n49 In modern corporation law, such self-dealing behavior, while not flatly forbidden, is subject to the most searching degree of judicial scrutiny. n50 The remedies for breach of the duty of loyalty may extend not only to compensating the beneficiary for out-of-pocket loss occasioned by the breach, but also to disgorgement by the fiduciary of profits gained from the breach. n51

Where the self-dealing fiduciary, in order to avoid strict judicial scrutiny and expansive remedies for breach of the duty of loyalty, seeks the consent of the persons whose interests the fiduciary is charged to protect, the law invariably insists that such consent be fully informed. n52 That insistence reflects and buttresses the severity of the rules limiting fiduciary self-dealing generally. If the law did not insist that the fiduciary affirmatively demonstrate that the beneficiary's consent was fully informed, the force of restraints against self-dealing conduct could be readily avoided. n53 Therefore, the fiduciary has an affirmative duty to disclose all facts material to the benefi- [*1101] ciary's decision whether to consent to the self-dealing conduct of the fiduciary. n54 And indeed, much of the precedent applying a director fiduciary duty of disclosure has arisen in precisely the context in which the director relies upon stockholder consent to defend a transaction in which the director has a conflicting personal interest. n55

To posit and define a fiduciary duty of disclosure in the absence of conflicting personal interest, however, requires resort to fiduciary principles very different from those that characterize the duty of loyalty. That distinct set of fiduciary principles--essentially a facet of the duty of care--is evoked where directors recommend how stockholders should vote or otherwise act on matters affecting their stock. n56 In making such recommendations, directors ordinarily have far greater knowledge, or access to knowledge, than do non-managing stockholders. n57 Thus, directors who recommend that stockholders vote a certain way, or sell (or not sell) their shares in response to a tender offer, place themselves in a position in which stockholders necessarily and properly rely upon that superior knowledge in determining how to act on a matter directly affecting their own interests as stockholders.

In such circumstances, the law has placed some duty, often characterized as fiduciary, upon the informationally advantaged advising party to disclose material facts to the informationally disadvantaged party who reasonably and foreseeably relies upon the advice given. n58 In the absence of self-interest, the directors' function of managing the disclosure of information to stockholders is similar to the directors' function of prudent management of the affairs of the corporation generally. Both involve effort by the directors to manage corporate resources to serve the best interests of the stockholders. n59 Therefore, the directors' duty of disclosure in recommending stockholder action should mirror the directors' duty of care, requiring no more (and no less) than the exercise of due care by the directors in gathering and presenting to the stockholders the information material to the decision the stockholders are being called upon to make. Since directors are not strictly liable as insurers for the outcome of their disinterested business decisions, n60 disinterested directors should [*1102] likewise not be strictly liable as insurers of the completeness of the information they present to stockholders when they recommend stockholder action.

Where director self-interest is absent, there is no need for strict liability or disgorgement-type remedies to discourage fiduciary opportunism. Fiduciary attention to prudent management has been thought adequately encouraged by a regime in which director liability requires proof of negligence or "gross negligence," n61 and remedies are limited to compensating victims of fiduciary inattention for their resulting out-of-pocket loss. n62 More expansive liability and remedies have been thought unduly to discourage individuals from serving as directors. n63 Monetary remedies for breach of the director's duty to disclose material facts in connection with recommendations of stockholder action, then, as with breach of the duty of care and the analytically similar tort of negligent misrepresentation, n64 should be limited to loss sustained by the stockholders as a result of the breach.

E. Applying Fundamental Fiduciary Principles to the Director's Duty of Disclosure: A Preview and Summary

As more fully developed in the material that follows, the reasons for imposing a fiduciary duty of disclosure upon corporate directors justify application of such duty in a manner considerably less dramatic than some commentators have intimated. n65 Subject to laying a more detailed foundation below, the following paragraphs propose a restatement of the fiduciary duty of disclosure: [*1103]

1. In the case of a transaction in which directors have a material personal interest in conflict with the interests of the corporation or its stockholders generally, those directors owe a fiduciary duty, when seeking approval of the transaction by the vote of disinterested stockholders, to disclose all facts that are material to the stockholders' consideration of the transaction and that are or can reasonably be obtained through their position as directors. A failure to fulfill that duty of disclosure, whether culpable or not, will eliminate any validating effect that a favorable stockholder vote otherwise might have on the transaction. Unless the stockholder vote is a prerequisite to accomplishment of the transaction, however, that failure will not of itself constitute an independent wrong for which a remedy must be afforded.

2. Where directors buy stock directly from, or sell stock directly to, an existing outside stockholder--that is, a stockholder who is not a director, officer or controlling stockholder--those directors owe a fiduciary duty to the stockholder to disclose all facts that are material to the stockholder's consideration of the purchase or sale and that are or can reasonably be obtained through their position as directors. A failure to fulfill that duty of disclosure will subject the transaction to injunctive relief or rescission in appropriate circumstances, and will subject the directors to monetary liability measured by the out-of-pocket damages sustained by the outside stockholder, or, in appropriate circumstances, by the amount of profit realized by the director as a result of the transaction.

3. Where directors submit for stockholder approval, or communicate to the stockholders a recommendation with regard to, a transaction or matter in which they have no material personal interest in conflict with the interests of the corporation or its stockholders generally, but as to which stockholders may reasonably expect to rely on the recommendation of directors as to what action to take with regard to their shares--as, for instance, where directors make a recommendation in a Schedule 14D-9 n66 whether stockholders should tender their shares in response to a tender offer by a third party--the directors owe a fiduciary duty to exercise reasonable care to disclose all facts that are material to the stockholders' consideration of the transaction or matter and that are or can reasonably be obtained through their position as directors. A failure to fulfill that duty of disclosure may warrant an injunction against, or rescission of, the transaction, but will not be the basis for an award of damages against [*1104] the directors in the absence of (i) negligence or bad faith, (ii) reliance by the stockholders seeking to recover damages on account of that failure, and (iii) proof of damages proximately caused by that failure.

4. Where directors make a statement to the public generally which does not on its face solicit or recommend action by the stockholders, the directors have no fiduciary duty of disclosure, although they may be liable to stockholders under common law fraud principles for actual damages if their statement is false or misleading due to a knowing misstatement or omission of a material fact, and the stockholders rely on such misstatement or omission and sustain injury as a result.

II. Searching for the Source of the Fiduciary Duty of Disclosure: Two False Starts

A. The Statutory Myth

Several commentators have suggested that, at least under Delaware law, the source of the directors' fiduciary disclosure duty to stockholders is a statute which was adopted in 1899 and repealed in 1967 as part of the general revision of the Delaware General Corporation Law ("former section 144"). n67 Closer analysis, however, demonstrates that this suggestion is erroneous. The statute did not create or codify a fiduciary duty to stockholders. Instead, it merely codified a rule of common law fraud establishing liability to creditors and investors that was not rooted in, and did not depend upon, a preexisting fiduciary relationship. n68 [*1105]

From this statute--curiously, even long after its repeal--the Delaware Court of Chancery in Marhart, Inc. v. Calmat Co. inferred a continuing, common law duty on the part of corporate directors "to honestly disclose all material facts when they undertake to give out statements" concerning the condition or business of their corporation. n69 Having described this disclosure duty as one owed to stockholders, the court on reargument clarified that the duty is not owed to nonstockholders, not even persons who become stockholders in reliance on flawed disclosures by corporate directors. n70

Delaware's 1899 statute, however, is devoid of any language indicating that existing stockholders were the exclusive beneficiaries of the disclosure obligation that the statute either created or codified. To the contrary, the history of former section 144 shows that it operated as an antifraud statute of general commercial application by codifying the proposition that corporate creditors and purchasers of the corporation's securities could claim damages for fraudulent written statements made by the directors regardless of any lack of privity or pre-existing fiduciary relationship with those directors.

The predecessor of former section 144, and similar state statutes then existing, demonstrate the creditor and securities purchaser protection purposes of former section 144. Before 1899, the Delaware statute (first enacted in 1883) prescribed a monetary remedy that was quite clearly limited to those who extended credit to the corporation. n71 [*1106] Since liability for fraudulent written statements under statutes like the 1883 Delaware statute was limited to corporate debts, rather than consequential damages generally, cases interpreting similar statutes readily recognized the creditor protection purpose of the statutes. n72

The 1899 revision of the Delaware statute, however, expanded its scope. Like statutes previously adopted in California n73 and in Illinois, n74 it extended liability for fraudulent written statements beyond corporate debts to include damages sustained by any person, not just corporate creditors, resulting from the fraudulent statements. n75 Under this revised statute, persons who purchased or sold the corporation's securities in reliance on knowingly incorrect representations published by the directors or officers about the condition or business of the corporation could assert fraud claims against those directors and officers, even though they did not deal directly with those directors or officers. n76 Although the revised 1899 Delaware statute may [*1107] have been superfluous in light of existing case law, n77 legislative intent to afford a remedy to defrauded stock purchasers seems apparent. n78 The statute's purpose of protecting investors generally, rather than just existing stockholders, is also quite plausible since it predated by thirty-four years the enactment of comprehensive federal regulation of disclosure in stock issuances. n79

After the enactment of federal securities laws governing fraudulent issues of stock, however, state corporation statutes became increasingly irrelevant to the protection of creditors. n80 Statutes like former section 144 generally atrophied or disappeared altogether as a result of disuse. n81 The vestigial successor to such statutes, section [*1108] 1.29 of the Model Business Corporation Act, prescribes only criminal misdemeanor liability, rather than civil damages liability. n82 Even that criminal liability is limited to false statements in filings with the secretary of state or the equivalent office, and does not extend to statements in corporate disclosures in general. n83

Former section 144 disappeared when the Delaware General Corporation Law was revised in 1967. n84 Cited in only one reported case while it was still in force, n85 former section 144 has been dusted off in Marhart and in scholarly comment to sustain and define a doctrine of fiduciary duty that the statute was never intended to encompass during its life, let alone after its death by repeal. The true source of the fiduciary duty of disclosure of corporate directors must therefore be found elsewhere.

B. Distinguishing Common Law Proxy Disclosure Obligations From a Fiduciary Duty of Disclosure

At least one observer has suggested that a fiduciary duty of directors and officers to disclose material facts to stockholders can be traced to cases which apply common law principles to evaluate claims [*1109] of false or misleading solicitation of proxies. n86 There is some truth to this perception, inasmuch as directors and officers have long been held to have obligations of disclosure, sometimes characterized as "fiduciary" in nature, when they solicit proxies. n87 Certainly, state law challenges to proxy solicitation disclosures were quite common, n88 at least until 1964 when federal regulation of proxy solicitation was extended beyond stock exchange listed issuers. n89 [*1110]

Nevertheless, these older proxy solicitation cases should not be viewed as the source of a fiduciary disclosure duty of directors. As these cases make clear, the duty to avoid fraud in the solicitation of proxies, and not any duty arising from a preexisting fiduciary relationship, forms the basis for scrutiny of proxy solicitation disclosures under common law. n90 Thus, the disclosure duties articulated in the [*1111] state law proxy solicitation cases unquestionably apply not only to incumbent directors and officers but to dissident or insurgent proxy solicitors as well. n91

At least with the benefit of hindsight, moreover, it seems inappropriate to characterize as "fiduciary" the common law disclosure duty of proxy solicitors, both management and dissident. The cases that used that terminology did not explain why a fiduciary relationship should be deemed to govern the actions by which a proxy is obtained, as distinguished from the use and execution of proxy authority once it is conferred. n92 Indeed, the relationship of solicitee to solicitor does not, in and of itself, involve any of the vulnerability and expectation of reliance that ordinarily justify application of a fiduciary obligation. n93

Perhaps reflecting that view, most observers have suggested that the older state law proxy solicitation cases are not a viable source of the more recently articulated director's "duty of candor," or the [*1112] fiduciary disclosure obligation of directors and officers. n94 This Article therefore turns in the following sections to cases in which the courts have articulated a duty of disclosure explicitly attributed to the fiduciary status of the director.

III. The Traditional Contexts of the Fiduciary Duty of Disclosure

A. Ratification Disclosure Duty

The first and oldest instance in which the courts have invoked fiduciary duties as a basis for a director disclosure duty is the unwavering requirement of disclosure of material facts where corporate fiduciaries solicit and rely upon stockholder consent to a transaction between the fiduciary and the corporation. n95 In Cahall v. Lofland, n96 the Delaware Chancellor stated the requirement concisely: "The burden is on him who relies on a ratification to show that it was made with a full knowledge of all material facts." n97

The reasons why corporate managers seek stockholder ratification are varied. In some cases, stockholder ratification is intended to supply retroactive corporate authority for action taken by directors or others whose authority to take the action has been questioned. n98 In others, corporate fiduciaries seek ratification in order to secure favorable judicial treatment of transactions alleged to involve self-dealing or waste that might otherwise be reviewed under a more stringent [*1113] standard, such as "entire fairness." n99 Even in cases in which stockholder approval is a statutory prerequisite to accomplishing the challenged transaction, and thus where the term "ratification" may be inapt, n100 corporate fiduciaries invoke the stockholder vote in a similarly defensive way, to reduce the intensity of judicial scrutiny, or avoid such scrutiny altogether. n101 In all of these contexts, however, the effectiveness of the ratification defense depends upon proof that the stockholders were fully informed about what they were approving when they approved it. If such proof is not forthcoming, the challenged transaction is examined without the curative or burden-shifting effect of stockholder approval. n102

Many of the Delaware cases which describe a fiduciary duty of disclosure or of complete candor do so merely in an effort to determine whether stockholder approval may be invoked defensively. In fact, the Delaware courts first used the term "complete candor" in such a case, nearly twenty years before Lynch elevated the term to common [*1114] parlance in corporate law. n103 In Gerlach v. Gillam, the defendant director, who by management contract exercised substantial influence over the affairs of the corporation, invoked stockholder approval n104 of agreements providing for the issuance of stock to corporations which he controlled. These issuances would give him "control of the corporation as a practical matter." n105 Defendant urged, and the court agreed, that fully informed stockholder ratification ordinarily validates even a self-dealing transaction. n106

The ratification defense failed, however, because of a failure to satisfy the disclosure duty identified by the court--the defendant's "obligation to exhibit complete candor in dealings involving a conflict between his personal interests and those of [the corporation's] stockholders" generally. n107 This disclosure duty is merely the universally recognized duty of a fiduciary to establish that the trust beneficiary's consent was fully informed when the fiduciary relies on that consent to sustain a transaction approved by the fiduciary and challenged on the basis of self-dealing or waste. n108

It was thus quite natural that after Lynch, the courts would invoke the "complete candor" language in defining the disclosure duty of a fiduciary relying on stockholder ratification of a transaction challenged as a breach of fiduciary duty. For instance, less than four months after Lynch, the Delaware Court of Chancery read Lynch broadly to require that "any contention that a proxy solicitation failed to completely inform stockholders must be given careful scrutiny." n109 The court recited this broad legal proposition, however, merely to determine whether the stockholders had effectively ratified stock option plan amendments challenged as a waste of corporate assets. Finding "complete candor" in the defendants' proxy statement, the [*1115] court concluded that the stockholders' ratification of the option plan amendments cured any lack of authority for the amendments. n110 As in Lynch, however, the court's language defining the fiduciary duty of disclosure was not limited to the context of the case. n111 This kind of language paved the way for later application of the fiduciary disclosure doctrine in entirely novel contexts, removed from the ratification setting in which the court appropriately insisted upon full disclosure as a condition to favorable judicial treatment resulting from stockholder approval. n112

B. The Fiduciary Disclosure Duty of Directors Purchasing Stock on the Basis of Inside Information: The Proper Context of Lynch v. Vickers

Lynch has been described variously as "the genesis of Delaware law regarding disclosure obligations;" n113 "the modern impetus for the rule" of fiduciary disclosure; n114 the beginning of "the principal evolution of the state law duty of disclosure;" n115 and "the seminal Delaware case" defining the fiduciary duty of "complete candor." n116 These characterizations of Lynch are undoubtedly correct if the reaction of the bench and bar to a case is what defines it as "seminal." Lynch's broad language elicited a spate of claims of breach of fiduciary disclosure duty, including some which had foundation at most in the language, but certainly not the rationale, of the case. n117 To character- [*1116] ize Lynch as seminal, however, may be misleading insofar as it suggests that Lynch announced some novel legal doctrine. To the contrary, that case is best understood not as the tap root of the fiduciary disclosure doctrine, but as merely a growth point, albeit a significant one.

The branch to which Lynch can fairly be traced is venerable. As almost anyone who has opened a corporation law casebook or treatise knows, there has been for over a century a conflict of authority as to whether in connection with a purchase of stock a director owes a fiduciary duty to disclose to the selling stockholder material facts which are not known or available to the selling stockholder but are known or available to the director by virtue of his position as a director. n118 The rationale for such a duty in this context is not hard to perceive. The presumptively superior knowledge and control of the corporate insider affords the insider such an advantage in buying the corporation's shares from, or selling them to, an outside or minority stockholder that fairness and fiduciary principles demand more thorough disclosure from the insider than the mere avoidance of intentionally false statements required by common law fraud doctrine. n119

The precedents in this area, however, are at least superficially quite divergent in their evaluation of what disclosure fiduciary duty requires in the director stock purchase context. A supposedly "majority" rule disavows the existence of any general fiduciary duty in this context, and holds that directors have no special disclosure duties in the purchase and sale of the corporation's stock, and need only refrain from misrepresentation and intentional concealment of [*1117] material facts. n120 The ostensibly opposing "minority" view broadly requires directors to disclose all material information bearing on the value of the stock when they buy it from or sell it to another stockholder. n121 Some courts have adopted a middle approach, known as the "special facts doctrine," that rejects any comprehensive fiduciary duty but allows that in some circumstances directors owe a duty to disclose material information to persons from whom they purchase the corporation's stock. n122 Such circumstances are identified, not altogether helpfully, as "special circumstances" or "special facts" that make the fiduciary's failure to disclose material information particularly unfair in connection with the purchase or sale of stock. n123

Although the split of authority in this area is surely more semantic than real, n124 the progress of the Delaware courts in the area is the key to understanding the development of the fiduciary duty of disclosure. Properly understood, Lynch did not create a fiduciary duty of disclosure of universal application, requiring directors to disclose material corporate information in any and all contexts in which such disclosure might affect stockholder action. At most, Lynch represented the adoption in Delaware of the so-called "minority" view that a fiduciary who purchases the corporation's stock must disclose to the selling stockholder inside information that is material to the sale decision.

Before Lynch, the Delaware courts were said to have espoused the so-called "majority rule," under which directors are obliged, when they purchase their corporation's stock from an outside stockholder, only to avoid fraudulent misrepresentation and concealment. They are not broadly obliged to disclose material facts known to them [*1118] through their corporate office. n125 Close review of the pre-Lynch Delaware cases, however, makes their nominal adherence to the "majority rule" appear less rigid, and the rule of law announced in Lynch something less than a wrenching departure from Delaware precedent.

In Kors v. Carey, n126 the opinion identified as adopting the "majority rule," the Court of Chancery addressed and rejected a claim by a regretful greenmailer whose shares had been purchased by the issuing corporation following a threat to the incumbents' control but had dramatically increased in market value following the repurchase. n127 Accused in a derivative suit of aiding and abetting greenmail, n128 United Whelan responded with a cross-claim against the issuer seeking to rescind the repurchase of the subsequently appreciated shares, on the grounds that the stock had been repurchased through "over-reaching" on the part of the directors. n129

In this context, in which the alleged greenmailer sought to undo a sale of stock that had dramatically increased in value following the repurchase, the court explained its views about the fiduciary disclosure duty, or lack thereof, of directors purchasing stock from a stockholder. The court ruled that directors generally do not owe a fiduciary disclosure duty to individual stockholders from whom they purchase stock, and it limited any such duty to what it described as special cases. n130 [*1119]

These pronouncements of law, however, were significantly broader than was necessary to arrive at the result reached. It is hardly stunning that United Whelan, a substantial business entity whose president was "skilled in the art of evaluating securities, a skill which he applied" to the acquisition of the "greenmailed" stock, n131 should not be favored with the protection of a fiduciary duty of disclosure designed for the protection of the informationally disadvantaged. n132 In any event, the only basis of United Whelan's nondisclosure claim had nothing to do with a failure to reveal information about the issuer's business. To the contrary, United Whelan apparently relied only on a claim, which it failed to establish at trial, that the issuer's broker misled United Whelan into believing that the purchaser was someone other than the issuer. n133 On its facts, therefore, Kors could not be considered a major defeat for advocates of fiduciary obligations more demanding than the "majority rule."

The approval of the "majority rule" in Kors was embraced by the Delaware Supreme Court six years later in Lank v. Steiner. n134 That case, however, was likewise not one that should have unduly alarmed critics of the "majority rule," at least in light of the facts as found by the trial court. Lank involved a close corporation in which the selling stockholder was also an officer of the corporation and was actually aware of the allegedly "special circumstance"--a third party's offer to purchase all of the corporation's stock at $ 600 per share--when he entered into the transaction subsequently challenged by his heirs. n135 The trial court had found as a fact, moreover, that the [*1120] seller had placed no confidence in or reliance upon his fellow officer, the purchaser. n136 Although the facts clearly could have been interpreted differently, it should not have been controversial to apply the "majority rule" in a case in which the selling stockholder was found not to have been informationally or procedurally disadvantaged relative to the purchasing fiduciary.

At any rate, even if the leaning of the Delaware courts toward the "majority rule" had been more than semantic, the legal atmosphere surrounding the Lynch litigation, less than ten years after Lank, foretold vigorous scrutiny of the responsibilities of majority stockholders to minority stockholders, and the likely demise of any doctrinal adherence to the "majority rule." Treatment of minority stockholders by majority stockholders, particularly in the area of going private transactions, was the subject of extensive litigation. n137 At the same time, the supposed reticence of the Delaware courts in enforcing corporate fiduciary duties was being vigorously criticized, particularly with regard to treatment of the fiduciary duty to disclose material facts in connection with a majority stockholder's purchase of corporate stock. n138 Moreover, any rigid adherence in the Lynch litigation to a "majority rule" rejecting such a duty would have faced another significant obstacle. By the time Lynch was decided in 1977, the composition of the Delaware Supreme Court had changed--Chief Justice Daniel F. Wolcott, the author of the majority opinion in Lank, had retired. He was replaced by Justice Daniel L. Herrmann, who had dissented vigorously in Lank. Justice William Duffy, who ultimately wrote the opinion in Lynch, had joined the Court. n139

Perhaps recognizing the direction of prevailing discourse on the subject of majority stockholder fiduciary duties, the defendants in Lynch--the majority stockholder, Vickers Energy Corporation, and [*1121] the directors of the subsidiary, TransOcean Oil, Inc.--did not dispute that they owed the minority stockholders of TransOcean a "duty of complete frankness" in connection with a tender offer by Vickers for the minority shares. n140 The trial judge in Lynch--Chancellor William Marvel, who had decided Kors--likewise acknowledged that the majority stockholder owed a fiduciary duty of "complete candor" and that such a duty paralleled the duty owed by corporate directors. n141

Not surprisingly, the Delaware Supreme Court readily agreed with this articulation of a fiduciary duty of disclosure. n142 In identifying a "fiduciary duty . . . which required 'complete candor' in disclosing fully 'all of the facts and circumstances surrounding the tender offer," n143 the Delaware Supreme Court did not truly break new legal ground. Lynch thus aligned Delaware with jurisdictions rejecting the "majority rule" in favor of a rule recognizing a fiduciary duty on the part of directors, officers and controlling stockholders to disclose material facts, learned through their position with the corporation, to outside stockholders when buying stock from them. n144

After Lynch, then, Delaware law at a minimum imposed a fiduciary disclosure duty on majority stockholders acquiring stock from minority stockholders. Just as clearly, Delaware law required fiduciaries to disclose all material facts to stockholders where they rely on stockholder consent to a self-dealing transaction. n145 Naturally, then, a most emphatic articulation of fiduciary disclosure duty appeared in a case combining both of these elements. That is, a case in which a majority stockholder relied upon a favorable vote of the mi- [*1122] nority stockholders to obtain approval of a merger in which the minority's shares were converted into cash and were thereby effectively acquired by the majority stockholder.

This case was Weinberger v. UOP, Inc. n146 It involved a merger in which the 50.5% majority stockholder acquired the shares of the 49.5% minority in a cash out merger conditioned upon the approval by a majority of the minority shares voting on the merger, n147 and defendants' reliance on that vote to establish the validity of the transaction. n148 Applying what it described as "the obvious duty of candor required by Lynch," the Delaware Supreme Court ruled in sweeping language that "one possessing superior knowledge may not mislead any stockholder by use of corporate information to which the latter is not privy." n149 Having found the disclosures to the minority stockholders inadequate, the court found the approval meaningless. n150

Notwithstanding the breadth of the language in Lynch and Weinberger, those cases should not have been understood to require directors to disclose to stockholders all material facts in any and all contexts in which those facts might be significant to stockholders and regardless of the directors' self-interest or lack thereof. Rather, the disclosure requirements articulated in Lynch and Weinberger should be applied only to transactions in which directors, officers, or controlling stockholders acquire or sell stock of the corporation and profit, to the detriment of the outside stockholders, while in possession of material non-public information about the business of the corporation derived from their positions with the corporation. As discussed fur- [*1123] ther below, n151 this reading of Lynch amply explains the basis of many subsequent opinions, including Weinberger itself, which purport to stand for a broader fiduciary duty of disclosure.

IV. From Ratification to Reification: Smith v. Van Gorkom and Its Progeny

A. Smith v. Van Gorkom as a Disclosure Case

Through and including Weinberger, the decisions of the Delaware Supreme Court can be traced to one or more traditional strands of fiduciary disclosure doctrine. In its next major pronouncement on the subject after Weinberger, however, the Delaware Supreme Court extended the logic and lilt of the language in Lynch to announce a fiduciary disclosure duty in a context outside of any of those traditional strands. The broadly worded but abstract language of the earlier opinions finally found embodiment in what was, to the directors of a large publicly held corporation, a painfully concrete, although novel, form.

This reification occurred in the controversial opinion in Smith v. Van Gorkom. n152 That opinion is best known for its finding that the [*1124] directors of Trans Union Corporation, all concededly disinterested and independent, breached their fiduciary duty of care in approving an arm's length merger in which Trans Union would be acquired at a cash price forty-five percent higher than the prevailing price of the stock on the New York Stock Exchange. n153 The fiduciary duty of disclosure figured importantly in the case, however. The court devoted considerable effort to evaluating whether the disclosures to the Trans Union stockholders were adequate. n154

It would be intellectually convenient to attribute that effort solely to the court's evaluation of the directors' defense of stockholder ratification. As previously discussed, the invocation of stockholder ratification as a defense is a conventional occasion for judicial review of the sufficiency of disclosure. n155 Indeed, it is possible to view Van Gorkom through the lens of ratification doctrine. The court indicated that informed stockholder approval of the merger would have extinguished altogether any claim of breach of the directors' duty of care in approving the merger agreement and submitting it to the stockholders for approval. n156 Necessarily, then, the court examined the suffi- [*1125] ciency of the disclosures, citing conventional ratification law. n157 When the court described the directors' disclosure obligation as "their original duty of knowing, sharing, and disclosing information that was material and reasonably available for discovery," it was still possible to view that "original duty" of disclosure as not really "original" or free-standing but merely ancillary to the holding that immediately ensued: that the directors' defense of stockholder ratification failed because the Board failed to meet its burden "to establish that the shareholder approval resulted from a fully informed electorate." n158

It is unfortunate, then, if only for reasons of analytical clarity, that in a facet of the opinion much less heralded than its duty of care ruling, Van Gorkom took one further, significant step to enunciate an independent duty on the part of directors to disclose material information when submitting a merger proposal to stockholders and to authorize a post hoc damages remedy against directors who fail to fulfill that duty. n159 That further step came when the court, summarizing its holdings, ruled that the Trans Union directors breached their fiduciary duty not only by their failure to be adequately informed, but also "by their failure to disclose all material information such as a reasonable stockholder would consider important" in voting on the merger proposal. n160

Thus, the majority found a breach of fiduciary duty, and endorsed a damages remedy against the directors, not only in regard to their lack of care, but also separately in regard to their failure to disclose material facts to the stockholders. Any doubt that Van Gorkom took this additional step was eliminated by the Delaware Supreme Court in Cinerama, Inc.

v. Technicolor, Inc. n161 The court noted that in Van Gorkom the Trans Union directors had violated not only their duty of care, but also their duty of disclosure. n162

From where did this independent, reified duty of disclosure, and its concomitant damages remedy, emerge? The few cases Van Gorkom cites in this context are all either plain ratification cases or cases where a majority stockholder acquires stock from minority [*1126] stockholders. n163 Those cases, however, do not even establish the existence of a comprehensive duty on the part of directors to disclose all material facts whenever they seek stockholder action, much less a money damages remedy against directors who are found to have failed to discharge that duty. This is not to say that such a duty does not exist. n164 The point here is simply that Van Gorkom failed to supply any precedent or rationale to support the existence of such a duty.

B. The Fiduciary Disclosure Concept Broadens: Further Repercussions From Lynch and Van Gorkom

Given the breadth of Van Gorkom's duty of disclosure, stockholder plaintiffs would inevitably seek to apply that abstract fiduciary disclosure obligation in unprecedented settings. And just as inevitably, trial judges dealing with expansive appellate court language would find it more comfortably appeal-proof to interpret fiduciary disclosure obligations broadly, especially if they were satisfied that there was in fact no material nondisclosure. n165

Van Gorkom's extension of fiduciary disclosure duty to the solicitation of proxies in a proposed arm's length merger was duly followed by the court of chancery. n166 Indeed, the sweeping rhetoric of Van Gorkom and Lynch was cited in other settings in which a fiduciary disclosure duty was applied as a basis for relief where it had not previously been recognized to exist. If a fiduciary duty required directors to disclose all material facts when presenting a merger proposal to stockholders for a vote, inevitably this duty would also require such disclosure when directors present any other matter for a stockholder vote. Hard on the heels of Van Gorkom, the court of chancery so held, [*1127] in Lacos Land Co. v. Arden Group, Inc. n167 In Lacos Land, the court relied on a breach of the "duty of candor" as an alternative basis for a preliminary injunction against implementation of a charter amendment proposal that would have established a dual class equity structure designed to buttress the control of the corporation's chief executive officer, who held twenty-one percent of the outstanding stock. n168 Citing Van Gorkom and Lynch and carrying the language of those cases to their logical end, the court reaffirmed the extensive sweep of the "duty of candor." n169

The court in Lacos Land did not, and was not called upon to, evaluate the entire range of remedies for breach of this fiduciary duty. For purposes of granting a preliminary injunction, however, the court found the likelihood of such a breach, without regard to whether the omitted material fact was omitted from the proxy statement out of neglect, malice, or on good faith deliberation including advice of counsel. n170

Soon after Lacos Land, the wave from Lynch and Van Gorkom traveled still further, into an area in which the directors were not literally seeking stockholder action: management recommendations in a Schedule 14D-9 submitted to stockholders in connection with a third-party tender offer. n171 In Weinberger v. Rio Grande Industries, Inc., n172 suit was brought against Rio Grande and its directors by a class of stockholders as of the date on which a third party bidder, acting under an acquisition agreement approved by the board of Rio Grande, commenced a cash tender offer. n173 The court of chancery denied defendants' motion for summary judgment, finding that information about the risks associated with a pending Interstate Commerce Commission proceeding might have been material, and the failure to include that information in the Schedule 14D-9 thus may have violated what it characterized as a well-settled fiduciary duty of [*1128] the directors to disclose all facts germane to a transaction in which stockholder action is contemplated. n174

The Rio Grande court cited no authority for applying this "well-settled rule" to a damages action against directors who lacked any personal interest in the transaction and were not even taking action under state law to place a matter before the stockholders for their consideration or action. n175 The directors were merely providing information, as required by federal law, in response to an initiative by a third party. n176 Again, as in Lacos Land, the court's opinion did not examine--and presumably considered irrelevant--whether the directors' omission of the potentially material information about the ICC proceeding was negligent, malicious or the result of good faith deliberation, including reliance on counsel.

From Rio Grande, it was not an implausible leap across the border to extend the fiduciary duty of disclosure to any situation in which a public statement approved by directors might affect the stockholders' decision whether to sell their shares, or buy more shares, even in the absence of a pending tender offer. That leap occurred, albeit with some notable restraint, in the court of chancery's opinion in Marhart, Inc. v. Calmat Co. n177 In Marhart the court concluded that corporate directors, as fiduciaries, owed the stockholders a duty, not owed to nonstockholders, as it turned out, n178 "to disclose all [*1129] material facts when they undertake to give out statements about the business to stockholders." n179

Curiously, as previously discussed, n180 the court relied on a statute repealed twenty-five years earlier as the source of this duty. By virtue of that reliance, however, the court sharply limited the scope of any damages claim. By invoking the repealed statute, the court simultaneously adopted the elements of the cause of action embodied in that statute, namely (1) an affirmative misrepresentation, (2) "knowingly made" by the directors, (3) as a result of which (4) plaintiff suffered damages. n181 In this context, at least, the fiduciary duty of disclosure had taken on the falsity, scienter, reliance/causation and damages requirements that were notably absent in earlier cases discussing the doctrine. n182

C. Attempts to Limit and Further Define the Fiduciary Duty of Disclosure: From Stroud to Arnold

Even before Marhart, the Delaware courts had begun to recognize that the fiduciary duty of disclosure was not unlimited, and to cut back on the theoretical scope of the duty. In Raskin v. Birmingham Steel Corp., n183 for instance, the court of chancery addressed a claim that the directors' fiduciary duty required them, in the absence of any public statement or filing, to disclose adverse financial developments that might reduce the likelihood that a previously announced merger agreement would be consummated. The court summarily rejected the notion that such a fiduciary disclosure duty existed, articulating the view that such a disclosure duty is limited to cases where the directors seek stockholder action in the form of a vote, purchase or sale of stock, or "otherwise." n184 Paralleling the [*1130] federal securities laws doctrine, the court reasoned that under state law, "business reasons" of confidentiality might well permit the corporation to refrain from disclosing even information that would be highly material to a stockholder's decision to sell stock or buy additional shares. n185

The articulation of the fiduciary disclosure duty in Raskin--limiting it to situations in which directors seek stockholder action--was a reasonably fair distillation of the Delaware case law, although not entirely consonant with the cases establishing a "duty of candor" where directors, although not placing a matter before stockholders for their action, make Schedule 14D-9 disclosures in response to an arm's length tender offer. n186 Even though lack of precedent may be a healthy reason for rejecting a proposed common law rule, however, the court in Raskin offered no affirmative authority or rationale, other than the interest in preserving the confidentiality of sensitive information, to justify the limitation it articulated. n187 In fact, a fiduciary duty to disclose material information to stockholders when the directors realize that the stockholders are buying, or refraining from selling, stock despite still undisclosed highly adverse corporate information is an entirely plausible corollary of the general duty of trustees to disclose material facts which the trustee knows may affect the actions and interests of the cestui que trust. n188 [*1131]

Soon after Raskin, in any event, the Delaware Supreme Court had several occasions to evaluate and limit the reach of the fiduciary duty of disclosure that its earlier opinions in Lynch and Van Gorkom had so stirringly articulated.

1. Stroud v. Grace

Ultimately decided by the Delaware Supreme Court in 1992, Stroud v. Grace n189 involved a closely held corporation controlled by family members owning over 50% of the outstanding stock. n190 Dissident stockholders owning 17% of the stock brought suit challenging various charter amendments relating to corporate governance. n191 Plaintiffs advanced several theories in support of their challenge to the amendments, including a claim that the directors owed, but failed to fulfill, a duty of complete candor in connection with the stockholder vote on the amendments. n192 Plaintiffs advanced this theory despite the facts that (1) no proxies were solicited by management, (2) directors controlling a majority of the stock supported the amendments and could provide the necessary stockholder vote without the support of any other stockholders, and (3) the dissenting stockholders had no investment decision to make in connection with approval of the challenged amendments. n193 In short, the directors [*1132] were charged with having breached a fiduciary duty of candor by failing to disclose information to stockholders in a context in which the only conceivable purpose of disclosure would have been to provide a basis for evaluating the merits of a motion for a preliminary injunction against implementation of the charter amendments.

In an early phase of the controversy, the Delaware Supreme Court dismissed an appeal as unripe. n194 In analyzing the ripeness issue, however, the court announced a ringing endorsement of the concept, previously expressed in Lacos Land and Raskin, that directors seeking stockholder action have a fiduciary duty to disclose to stockholders all facts material to that action that the directors know or can reasonably obtain through their control of the corporation. n195 This duty applies to stockholder actions modifying rules of corporate governance, as well as to business transactions. n196

Not unreasonably, the court of chancery on remand accepted these admonitions at face value, and found that the directors could not avoid their disclosure duty by determining not to solicit proxies in [*1133] connection with adoption of the questioned charter amendments. n197 Moreover, the court continued, the "duty of candor" requires that the necessary material information be disclosed sufficiently in advance of the stockholder meeting so that stockholders can adequately evaluate the significance of that information to the matters to be voted upon. n198

Interestingly, however, the court appeared to disavow any affirmative duty to disclose. Rather, the court merely examined what limited disclosures were made, in the notice of meeting and at the meeting itself, to determine whether they contained any material misstatements or omissions. n199

On appeal, the directors maintained that their disclosures to stockholders in connection with the proposed charter amendments were sufficient under any standard of fiduciary disclosure duties, and that those duties did not require them to disclose in advance of the stockholder meeting any more than the minimal information prescribed by statute. n200 "It is the meeting of stockholders," defendants continued, "that is the medium for providing any additional information contemplated by the Corporation Law (e.g., sections 211, 242 and 251)." n201

The Delaware Supreme Court could have easily resolved the matter the way the lower court did by reciting the now familiar mantra, that directors owe a fiduciary duty to disclose all material facts when they seek stockholder action, and determining that all material facts had been disclosed. Instead, in apparent disregard of its own recitation of that mantra in Stroud, n202 the court repeatedly took the [*1134] trial court to task for adopting "a novel legal framework" and a "novel legal analysis" for evaluating plaintiff's fiduciary disclosure claims. n203 The court then proceeded to articulate a theory that imposed significant, although poorly defined, limits on the reach of the fiduciary duty of disclosure.

After uttering the mantra, the court explained that the duty of disclosure must be evaluated not "in a vacuum" but in the context of statutes requiring and defining the content of notice to stockholders of meetings to act on charter amendments and the like. n204 The court then found that those statutes supply the exclusive definition of the directors' disclosure obligations under state law, "in the absence of a proxy solicitation." n205 It is that circumstance which the court identified as the source of the fiduciary duty of disclosure. "In the absence of that circumstance," the court explained, "questions of disclosure beyond those mandated by statute become less compelling." n206 "Thus," the court explained further, "what we say here is limited to nonpublic, privately-held corporations." n207

The court's emphasis on proxy solicitation as the source of the duty of disclosure, and its truncation of that duty in the case of privatelyheld companies, were both literally incorrect and analytically flawed. The court's limitation was literally incorrect because several of the court's prior opinions invoking and applying a fiduciary disclosure duty did not involve proxy solicitation at all. n208 Indeed, in Cahall, which Stroud described as the source of a "materiality stan- [*1135] dard that has been a mainstay of Delaware law for decades," n209 stockholders were never even asked to vote or otherwise take action upon the challenged transactions, let alone execute proxies. n210 Cahall, moreover, involved a company whose issued stock was no more, and probably less, widely held than the corporation involved in Stroud. n211

Stroud's limitation of the full-blown fiduciary disclosure duty to cases involving proxy solicitation in publicly held companies was analytically flawed as well. The facts on which the court relied in this regard--that large companies depend on proxy solicitation when seeking a stockholder vote and that proxy voters generally do not attend stockholder meetings n212 --do not demonstrate that fiduciary duty does not require disclosure of information beyond statutory notice requirements in contexts not involving public company proxy solicitations. If fiduciary principles require directors of public companies to provide material information to proxy voters in advance of a stockholder meeting, is there any good reason why those same principles would not require directors of less widely held firms to provide material information to proxy voters? n213 Similarly, is there anything in the rationale of those fiduciary principles that would moderate or eliminate the need for directors to provide material information to stockholders in advance of the meeting, even if their proxies are not solicited, as long as they are invited by notice to attend the meeting and vote, and their votes are necessary to the accomplishment of the action proposed to be taken at the meeting? n214 And if stockholder [*1136] ratification of a self-dealing transaction by directors is effective only if the proponents of the transaction disclose all material facts to stockholders in connection with their ratification vote, as is clearly the law, n215 is there any reason to limit or eliminate that disclosure duty in a privately held company and/or where no proxies are solicited in connection with the ratification vote? Certainly the opinion in Stroud offered no answer to these questions. n216

Having concluded, however, that the directors had no duty to disclose anything beyond the minimal information prescribed by statute, n217 the court in Stroud then proceeded to blunt the force of that very holding, by (1) suggesting that the absence of proxy solicitation [*1137] "does not lessen a board's fiduciary duty of disclosure" but results in "the emphasis of such disclosure . . . being shifted to that which occurred at the annual meeting," n218 and (2) proceeding to consider separately whether the directors "violated their duty of disclosure by their alleged misstatements and omissions at the annual meeting." n219 Does this mean that the difference, as concerns the fiduciary duty of disclosure, between public company proxy solicitations and private company stockholder meetings without proxy solicitation is merely a question of timing? Does the fiduciary duty of disclosure require the same disclosures in the latter case, but only at the time of the stockholder meeting and not in conjunction with the statutory written notice of the meeting? Such questions are analyzed in Part V, along with the suggestion that Stroud reached the correct result but should have been decided on the entirely different basis that no fiduciary disclosure duty should or could have attached under the circumstances where the minority stockholders were powerless to adopt or stop the proposed charter amendments and had no appraisal election to make and no state law basis for enjoining implementation of the amendments. n220

2. Zirn v. VLI Corp.

Although it pointedly rejected any fiduciary or statutory obligation of directors to disclose material facts in or with a notice of stockholders meeting where proxies are not solicited, Stroud re-endorsed the notion that directors could be held liable in damages for having issued a public statement to stockholders that misrepresented or omitted a material fact, even in connection with a transaction in [*1138] which they had no personal interest. The validity of this notion was squarely presented in Zirn v. VLI Corp. n221

In Zirn, the individual defendants had been directors of VLI Corporation, which had been acquired in a tender offer in December 1987 in which 94.8% of the stock was acquired, and then a short-form merger in January 1988. n222 The directors were charged with having failed to disclose material facts not in a proxy solicitation but in the Schedule 14D-9 filed on behalf of the directors in response to the first-step tender offer. n223 In defense, the directors urged that the Schedule 14D-9 had disclosed all material facts and that VLI's certificate of incorporation eliminated their monetary liability for any breach of fiduciary duty occasioned by any failure to disclose material facts. n224 Strikingly, the defendants never questioned the legal proposition that, despite the absence of self-interest, bad faith, or lack of care, n225 the directors could, but for the exculpatory charter provision, be found personally liable for damages for failure to disclose a material fact in the Schedule 14D-9. n226 Perhaps as a result, neither did the Delaware Supreme Court. The court's opinion found the exculpatory charter provision inapplicable n227 and remanded the damages case against the directors for a determination of materiality of the undisclosed information at issue. n228 [*1139]

3. Arnold v. Society for Savings Bancorp, Inc.

The underlying issue of whether disinterested directors can be held personally liable in damages for a breach of the fiduciary duty of disclosure was presented yet again in Arnold v. Society for Savings Bancorp, Inc. n229 In Arnold, the plaintiff brought a class action on behalf of stockholders of Society for Savings Bancorp, Inc. ("Society") whose shares were converted, in a merger with an acquisition subsidiary of Bank of Boston Corporation, into shares of Bank of Boston common stock. After the transaction was consummated following denial of a motion for a preliminary injunction, plaintiff sought damages, on a variety of theories, from the directors of Society who approved the merger but were not affiliated with Bank of Boston and had no other distinct personal interest in the merger.

The plaintiff's theory that elicited the greatest attention was the claim that the directors had breached a fiduciary duty of disclosure by omitting or misrepresenting material facts in the proxy statement submitted to stockholders in connection with the merger. Judgment for defendants, premised on a finding that no material facts had been omitted in the proxy statement, was appealed and argument was held in the Delaware Supreme Court on April 5, 1994. In the ensuing months, however, the composition of the court changed, with Chief Justice E. Norman Veasey replacing Justice Andrew G.T. Moore on the panel, and the court resolved to determine and rehear the case en banc. Perhaps as a result of that change, the court requested supplemental briefing on a number of issues and, at last, asked counsel to explain the nature of the fiduciary duty of disclosure that had been taken for granted in Zirn and, until that point, in Arnold as well. n230 In particular, the court asked for supplemental briefing on the following question: "Is the duty of disclosure a separate, free-standing fiduciary duty, or does it arise under, and always subsumed within, the duty of care and/or duty of loyalty?" n231

In understandably truncated briefing, n232 counsel ably highlighted their competing views. Plaintiff's counsel emphasized the broad language of Lynch, n233 the separate identification of a fiduciary [*1140] disclosure duty in Van Gorkom, n234 and cases granting preliminary injunctions based on nondisclosure despite findings of inadvertence and good faith on the part of disinterested directors. n235 Defendants' counsel noted the foundation of Lynch in the duty of loyalty n236 and stressed, without citing any authority, that to impose monetary liability on directors for good faith disclosure errors not resulting from negligence would contravene what they characterized as the "generally respected proposition" that directors cannot be held personally responsible for good faith judgments made with due care. n237

Unfortunately, the court did not use the opportunity to clarify the fundamental character of the fiduciary duty of disclosure. The court merely quoted Lynch's "complete candor" language, n238 noted blandly that "a number of subsequent decisions have recognized the existence of fiduciary disclosure obligations," n239 and cited Stroud for the proposition that the disclosure "obligation attaches to proxy statements and any other disclosures in contemplation of stockholder action." n240 The court concluded that the proxy statement contained an omission of material fact but that the directors were immune from monetary damages liability due to the exculpatory provision in Society's certificate of incorporation. n241

The implications of Arnold regarding the basic nature of the fiduciary duty of disclosure are unclear. One could contend that the court would not have reached the issues surrounding the exculpatory charter provision unless it had concluded that the fiduciary disclosure obligation carried with it the possibility of monetary damages even for what the court found was an innocent, unselfish breach of the obliga- [*1141] tion. n242 Alternatively, because it exonerated the directors based on the exculpatory charter provision, the opinion may have merely assumed, without deciding, that such damages liability could exist in the absence of an exculpatory provision.

The Arnold opinion also begged another important question about the scope of the fiduciary duty of disclosure--whether the duty is merely a rule against avoiding false or misleading statements or omissions, or whether it imposes an affirmative duty to disclose facts material to a pending stockholder decision. Clearly, the court found the undisclosed fact at issue, a pre-merger bid for a key division, to have been material solely because the directors had made partial disclosure about the related pre-merger efforts to sell the company which became materially misleading by omission of the undisclosed bid. n243 Just as clearly, the court disavowed any decision regarding whether the undisclosed fact "was material as a matter of law," n244 and to what extent, if any, the fiduciary duty of disclosure extends beyond a requirement of avoiding false or misleading statements to an affirmative duty to disclose. n245

Thus, the Arnold opinion still leaves to commentators the task of defining the full scope and content of the fiduciary duty of disclosure. n246 With the history of the Delaware case law on that subject now behind us, we turn next to how general concepts of fiduciary obligation can assist in that task.

V. The Application of Fiduciary Theory [*1142]

A. Conceptual Introduction

Defining the proper scope and content of the director's fiduciary duty of disclosure requires more than the expression by an individual judge of a personal preference or notion about the matter. The legitimacy of a legal doctrine under which judges may, in the absence of any statute, sanction private behavior through injunctive relief or an award of damages depends upon a rooting in what is perceived by the relevant community as traditional principle. n247 If a court is to require a corporate director to pay damages or to enjoin or rescind a corporate transaction because of a failure to disclose material information to stockholders, it may exercise such coercive power, in the absence of statute, only by invocation of such traditional principle.

What, then, are the traditional principles of the law of fiduciary duty that define the obligation of a corporate director to disclose material information to stockholders? To pose this question is much easier than to answer it. As "the legal system's attempt to recognize the more blatant abuses of the trust we place in each other," n248 the law of fiduciaries has been described as "the most human area of the legal system, and as such the most undefinable." n249 Attempts to identify the essential general principles of fiduciary relationships are still relatively rare. n250 Even a fairly recent attempt laments that "the precise nature of the fiduciary relationship remains a source of confusion and dispute," and that "legal theorists and practitioners have failed to define precisely when such a relationship exists, exactly what [*1143] constitutes a violation of this relationship, and the legal consequences generated by such a violation." n251

Nonetheless, and acknowledging that the exercise necessarily lacks scientific precision, n252 defining the director's duty of disclosure can proceed by first identifying the basic features of the director/stockholder relationship, and then examining what fiduciary responsibilities traditionally attach by reason of those basic features.

1. The Structure of the Director/Stockholder Relationship

The principal feature of the director/stockholder relationship is the allocation of managerial power. Directors are endowed by law with the power to exercise authority over the management of resources that are understood to belong, in terms of residual ownership interest, to others, namely the stockholders. n253 That managerial responsibility is most commonly discussed in relation to business deci- [*1144] sions as conventionally defined: building a factory, issuing stock, or approving a fundamental corporate change such as a merger. n254

Directors' managerial responsibilities, however, also include an advisory function. Directors must in certain circumstances make recommendations to stockholders regarding proposed actions that fundamentally affect the interests of the stockholders, such as mergers, n255 charter amendments, n256 sales of all or substantially all of the corporation's assets, n257 dissolution, n258 or tender offers to acquire stock of the corporation. n259 The allocation to directors of that advisory responsibility has an obvious rationale. As the ultimate repository and source of information about the corporation and its affairs, directors are most efficiently situated to provide information to stockholders when the stockholders are called upon to act on mergers, tender offers, and the like. n260

2. Concomitant Fiduciary Principles

Managerial power and influence over another's assets inevitably involve potential for abuse by the manager. Fiduciary duty is the brake applied by the law to the exercise of such power or influence. n261 The law of fiduciary duty imposes upon persons--such as corporate directors--who exercise such power or influence a responsibility to manage the resources of the common enterprise so as to maximize the profit derivable from those resources. n262 [*1145]

Such fiduciary responsibility, however, varies in its application. It is a brake applied most forcefully where those who exercise managerial powers do so in ways in which their own personal interests are served. n263 The moral disapproval and stringent sanctions meted out by the courts in this context are fitting. In a setting in which the directors' potential for gain from abuse of the relationship is great, the rules and tone of fiduciary law contribute to the confidence of stockholders that their investment will be managed faithfully. Thereby, fiduciary law helps preserve the socially efficient relationship of specialization that exists when directors are entrusted with authority to manage the resources of others. n264 By punishing directors who abuse their position by diverting corporate assets to themselves, deterring such behavior as well as compensating its victims, the fiduciary duty of loyalty reduces the risk associated with investment in corporate equity and the costs of monitoring the behavior of corporate managers and thereby reduces the cost of equity capital. n265

In the absence of self-dealing, however, the brake of fiduciary duty upon managerial action is less forceful. True, the law insists that directors and officers exercise reasonable care in managing the affairs of the corporation. n266 Judicial sanctions for disinterested but harmful decisions are limited, however, to cases of "gross negligence" or irrationality suggesting bad faith or recklessness. n267 The fiduciary duty of care, as thus refined by the "business judgment rule," n268 reflects a balance of regulation that reduces the costs of monitoring the behavior of corporate managers, avoids undue discouragement of [*1146] entrepreneurial risk-taking, and thereby enhances stockholder wealth. n269

3. Four Paradigm Contexts for Articulating the Director's Fiduciary Duty of Disclosure

Ordinarily, directors are not called upon by state law to communicate with stockholders in regard to exercising their managerial powers, inasmuch as stockholder consent to corporate action is generally not required. n270 There are occasions, however, when directors do communicate with stockholders, either voluntarily or out of regulatory obligation. Those occasions can be summarized in the following four paradigm contexts: (1) An effort by a director to obtain and invoke stockholder consent to a transaction between the director and the corporation; (2) Acquisition by a director of stock from an outside, public stockholder; (3) Recommendation by directors of stockholder action on a transaction in which the directors have no personal interest; and (4) Public statements by the directors not directed specifically to stockholders but potentially influencing stockholder investment decisions.

As will be seen, the fiduciary considerations applicable to these four paradigm contexts vary considerably. With the fiduciary principles previously discussed in mind, it is necessary to analyze each situation individually to determine whether a fiduciary duty of disclosure exists, who owes the duty, what disclosure such a duty requires, and what remedies are appropriate for a breach of the duty.

B. Ratification Disclosure and the Duty of Loyalty

As previously noted, n271 the courts reserve the harshest moral indignation for the actions of self-interested fiduciaries who use their position of authority to obtain benefits at the expense of those they are charged with protecting. n272 Corporation law, of course, does not [*1147] forbid self-dealing by directors. Frequently by statute, but by case law precedent as well, it tolerates self-dealing accompanied by assurances of fairness. n273 Where that assurance derives from the consent of the stockholders, however, fiduciary law is unsurprisingly demanding of proof that the consent is fully informed and otherwise fairly procured. n274 Because reliance on such consent is intended to deflect what would otherwise be the most severe judicial scrutiny, the fiduciary duty of disclosure in this context takes on its most stringent form, in what can be labeled a ratification duty of disclosure. The following questions and answers define more fully this venerable and robust subspecies of the director's fiduciary duty of disclosure.

1. Upon Whom Does the Fiduciary Disclosure Duty Rest?

The duty of disclosure rests upon the directors who invoke stockholder consent to a transaction in which their interest is in conflict with the interests of stockholders generally. n275 That duty may likewise rest, at least indirectly, upon those who actively participate [*1148] with such directors in the transaction. n276 The duty of disclosure, as it exists in this self-dealing context, does not rest upon other directors who have no personal interest in the transaction at issue and do not rely upon stockholder consent to avoid liability in connection with the transaction. n277

2. Is the Duty One of Affirmative Disclosure, or Merely Avoidance of Misrepresentation or Misleading Incompleteness?

Since the ratification duty of disclosure by definition exists only where self-dealing managers initiate communication with stockholders in order to obtain their consent to self-dealing conduct, it makes little practical difference whether the disclosure duty is defined as an affirmative duty to speak or merely a duty to avoid misleading incompleteness once some disclosure is made. n278 The ratification context presupposes that self-interested directors provide to stockholders at least some description of the transaction as a means of establishing effective stockholder consent. By virtue of a duty of completeness alone, then, all material facts relating to that description must be disclosed. n279 Moreover, stockholder consent can [*1149] not be considered effective unless the nature of the directors' conflict of interest is explained. n280 Thus, to the extent that the transaction and its effect on the corporation can be described, consistent with a duty of completeness, without revealing that conflicting interest, it could be said that the duty to disclose that interest is affirmative in nature, and not merely a duty of completeness. n281

It should not be inferred, however, that directors have an absolute, affirmative duty to disclose self-dealing to stockholders. A selfdealing transaction could be valid even if it is never revealed to stockholders, if it can be shown to have been intrinsically fair. n282 The absence of any absolute state law duty to disclose self-dealing points out the importance, in the public company context, of federal law requiring disclosure of management conflicts of interest. n283 Without such affirmative disclosure requirements, the widely acclaimed benefits of state fiduciary law restricting self-dealing could be substantially [*1150] reduced due to the understandable unlikelihood that widely dispersed individual stockholders, each with relatively little at stake, would expend the money and effort necessary to monitor managers' actions and thereby identify instances of self-dealing. n284

3. What Remedies are Appropriate for Failure to Fulfill the Duty of Disclosure in the Ratification Context?

This question is somewhat misleading since the ratification disclosure duty exists only as a prerequisite to defensive reliance on stockholder consent. Thus, nondisclosure is not the underlying wrong to be remedied in the context of ratification. The underlying wrong is the self-dealing transaction itself, and a disclosure shortcoming is relevant only in determining whether the transaction is supported by effective stockholder consent. n285 It is beyond the scope of this article to review extensively the range of potentially appropriate remedies for a breach of the duty of loyalty, but they clearly include rescission, injunctive relief, compensatory damages, and disgorgement of fiduciary profit. n286 Of course, an extensive, good faith effort to disclose material information in an effort to secure stockholder approval, even if flawed in some material respect, may serve as an indicium of fairness. In other words, in evaluating whether a self-dealing transaction unaccompanied by effective stockholder approval is nonetheless entirely fair, disclosure that is flawed for reasons other than bad faith or intent to deceive should be more favored by the law than none at all. n287 [*1151]

C. Insider Stock Purchases and the Duty of Loyalty

The next context in which a fiduciary duty of disclosure has been identified is the purchase by a director of the corporation's stock from an outside stockholder. n288 This is a highly variable setting, as discussed below, in which the concerns of fiduciary law are not monolithic. It is a setting, however, which involves one significant difference from the ratification context discussed in the preceding section. Specifically, the conflict of economic interests is no longer between the director and the corporate entity, but rather arises between the director/stock purchaser and the outside stockholder/seller. n289 Thus, one significant aspect of fiduciary relations associated with corporate directors is missing in the stock purchase context. At least where the director purchases stock for her own account, she is not acting in a role in which the stockholder and the law have entrusted her with responsibility for managing corporate assets. n290

Perhaps because of the absence of the asset-management underpinning of fiduciary responsibility, older case law adopted the view that directors purchasing stock from outside stockholders for their own account were under no fiduciary duty at all to disclose facts ma- [*1152] terial to the transaction. n291 This view, however, misconceives the fiduciary rationale of the disclosure duty. The force animating the cases imposing such a duty is the fact that it is the stockholders who retain and compensate managers, and it is the managers' use of corporate resources that enables them to gather material information. To permit the managers to use that information for their own personal benefit and to the disadvantage of those who have effectively funded its acquisition runs counter to fundamental agency principles of unjust enrichment. n292 Some commentators have also argued that permitting managers to profit from stock purchases made using material inside information tends to increase the risk perceived by investors in providing equity capital, and thereby increases the cost of such capital. n293

One could respond that outside stockholders, aware that they are dealing with a director, could simply negotiate to obtain a warranty that they have been provided with all material information. Failing to obtain such a warranty, the stockholder could either refrain from selling stock to the director or proceed knowing of the uncertainty of the informational base. None of these alternatives, however, can be viewed as efficient. Individualized negotiation of disclosure obligations would impose substantial transaction costs, particularly where a purchase offer is extended to many outside stockholders, as where a controlling stockholder makes a public tender offer for minority-held shares. Insisting, in the absence of such individualized negotiation, that stockholders refrain from trading with the fiduciary or accept the risk of inadequate information could only result in decreased stock prices and increased costs of equity capital. n294 [*1153]

In contrast, imposing a fiduciary duty of disclosure provides a convenient, ready-made substitute for what selling stockholders would want in any event--presentation of the material facts--and what directors, by virtue of their role as centralized repositories of corporate information, are well suited to provide efficiently. n295 That transaction cost-minimizing rationale for imposing a fiduciary disclosure duty would not apply, of course, in the case of stock purchases by directors in impersonal, market transactions, in which the seller is unaware of the identity of the buyer. In that situation, there would be no occasion for negotiation over the seller's disclosure. Perhaps tacitly recognizing that no negotiation transaction costs would be avoided in this setting by establishing a fiduciary duty to disclose material facts to the selling outside stockholder, the case law has generally prescribed none. n296 [*1154]

There is a further basis in fiduciary principles to impose a duty upon directors when they purchase stock directly from outside stockholders. The role of directors as corporate managers casts upon them the function of gatherers and holders of material corporate information, upon whom the outside stockholders reasonably, indeed necessarily, rely when the directors seek to acquire their shares. n297 That reliance on managers as a source of superior information is a traditional earmark of a fiduciary relationship of dependence, one that independently supports the application of a fiduciary duty of disclosure in the situation where an outside stockholder is approached by a director seeking to purchase his shares. n298 The absence of such a disclosure duty in arm's length relationships appropriately discourages such reliance in the interest of rewarding diligence in the gathering of information. n299 That approach is counterproductive, however, in the corporate setting, particularly where the number of stockholders is large, because it discourages the specialization of function, including information gathering, that the corporate structure usefully exploits. n300 Hence, a fiduciary duty to disclose material facts appropriately inheres in a director's purchase of stock directly from an outside stockholder.

With that introduction to the application of fiduciary principles in the stock purchase context, n301 the character of the fiduciary disclosure duty in that context can be sketched out, again using questions and answers. [*1155]

1. Who Owes the Fiduciary Duty of Disclosure?

This question is easily answered by reference to the circumstances giving rise to the fiduciary duty of disclosure in the stock purchase context. As previously discussed, the fiduciary duty arises because of the use by the fiduciary of information, learned through the performance of the fiduciary management function, in acquiring stock directly from outside stockholders. n302 Thus, the duty can rest not only upon directors but upon corporate officers n303 and controlling stockholders n304 as well. Those who actively participate with such corporate managers in the purchase of stock may take on indirect responsibility for adequate disclosure, n305 but any direct fiduciary duty of disclosure on their part seems unjustified in light of the rationales of the fiduciary duty. n306

2. In What Specific Circumstances is the Duty Owed?

The fiduciary duty of disclosure arises in the context of the acquisition of stock by a director directly from an outside stockholder, whether that acquisition occurs in a privately negotiated purchase, through a public tender offer, or through a merger effected by means of a vote of public stockholders. n307 Of similar fiduciary substance is the acquisition of outsider stock by the corporation itself, where caused by managers who have a sufficient ownership interest in the corporation so that their personal, albeit indirect, economic interest in respect of the repurchase conflicts materially with the stockholder's interest in receiving maximum value. The important aspect here is that the transaction arises by virtue of a volitional act on the part of the public stockholders affected by the purchase, whether that volitional act is a sale agreement, a tender in response to a tender offer, or the vote of the publicly held shares.

Where such volition on the part of the public stockholders whose shares are purchased is lacking--as in the case of a squeeze [*1156] out merger effected solely by means of the vote of the shares of a controlling stockholder--the fiduciary considerations are very different. n308 Certainly, the transaction cost reduction rationale for the fiduciary disclosure duty is absent where, as in the squeeze-out merger, there is no opportunity for negotiation. n309 Nevertheless, the element of reliance on the fiduciary's superior informational resources may still be present, even when there is no stockholder agreement to, or vote for, a sale. Stockholders usually must still choose whether to exercise appraisal rights. n310 For just such reasons, a fiduciary duty of disclosure has been applied in mergers unilaterally effected by majority stockholders. n311

A more attenuated form of conflict--a conflict of roles rather than of economic interest in the transaction--exists with respect to corporate stock repurchases generally. Some courts have suggested that where directors approve stock repurchases, even in the absence of any personal stock interest, they take on fiduciary disclosure obligations because they are serving the conflicting interests of those persons who sell their shares and those stockholders who retain their equity interest in the corporation. n312 That suggestion was made in a case in which the directors, representatives of holders of a controlling block of common stock, did in fact have a potent personal interest in achieving the lowest possible repurchase price for shares of preferred stock. In the case of a stock repurchase in which the directors have no such material conflicting interest, however, the central concern of fiduciary law over abuse of position for self-aggrandizement is absent. Only the fiduciary aspect of reliance upon directors on account of their information-repository function remains. n313 Accordingly, the fiduciary disclosure duty in this disinterested circumstance should resemble [*1157] the more limited duty, discussed in Part V.D, that exists generally when disinterested managers present a proposal to stockholders for voting or action that may affect the value of their stock, rather than the more stringent version of the fiduciary duty that exists in regard to self-interested stock purchases by corporate managers.

3. Is the Disclosure Duty Affirmative, or Does it Merely Require Avoidance of Material Misrepresentation or Incompleteness?

In the context of publicly held companies, federal law makes this question largely academic. Federal law prescribes mandatory disclosures whenever directors or controlling stockholders seek to acquire publicly held shares by means of a tender offer or merger. n314 With open market stock repurchases approved by disinterested directors not subject to any fiduciary disclosure duty, n315 and privately negotiated purchases between directors and public stockholders relatively rare, state fiduciary disclosure law in this area has largely addressed questions of material omission in federally mandated disclosure documents. n316

To the extent that the issue arises in the context of privately held companies and is therefore not preempted as a practical matter by the federal securities laws, the fiduciary duty of disclosure of a director purchasing stock from an outside stockholder should be characterized as a duty of affirmative disclosure, and not merely avoidance of material misrepresentation or misleading incompleteness. The fiduciary considerations are quite similar to those in the context of ratification of self-dealing. The director's personal economic interest in acquiring stock as cheaply as possible is adverse to the interest of the selling stockholder. The director is enabled to pursue that interest, to the detriment of the stockholder, by virtue of (1) access to information gained while carrying out the management function; and (2) the stockholder's necessary reliance on the director for material information concerning the transaction. With all these considerations present, the stockholder's consent to the director's stock purchase can no more be considered valid in the absence of full disclosure of material facts within the director's control than could the stockholder's [*1158] consent to a self-dealing transaction between the director and the corporation. Indeed, the stock purchase achieved without adequate disclosure could be considered more suspect, since it cannot even occur without the improperly secured volitional act of the selling stockholder.

4. What Are the Appropriate Remedies for Breach of the Fiduciary Duty of Disclosure in the Stock Purchase Context?

This question is one on which the case law, at least in Delaware, is fairly well developed. And, as one might expect given the equitable foundations of fiduciary law, n317 the range of potential remedies is extensive--again evidencing the similarity of fiduciary principles applicable in the stock purchase context and the more traditional self-dealing context. Potentially available remedies for a breach of the fiduciary duty of disclosure in connection with a stock purchase from an outside stockholder include rescission, n318 injunctive relief, n319 compensatory damages, n320 and disgorgement of fiduciary profit. n321 Indeed, where problems of evaluating compensatory damages from disclosure shortcomings in stock purchases have proved difficult, the Delaware courts have resorted to the use of somewhat arbitrary monetary awards, which have been characterized, not altogether accurately, as "nominal damages." n322 These cases have led the Delaware Supreme Court to state that "in Delaware existing law and policy have evolved into a virtual per se rule of damages for breach of the fiduciary duty of disclosure." n323 That approach to remedy--awarding damages in the absence of harm to the beneficiary--is [*1159] well-grounded in precedent in cases in which fiduciaries act disloyally, out of self-interest in conflict with those they are charged with representing. n324 As we see in Part V.D, however, it is hardly appropriate as a general approach to the treatment of fiduciary disclosure problems where no conflicting personal interest is at stake.

D. Disinterested Recommendations of Stockholder Action

The next context of fiduciary disclosure obligations to consider is the common situation in which disinterested directors ask stockholders to vote or otherwise take action on a matter as to which the directors have made a recommendation. Usually by statute n325 or implementing regulation, n326 the law has set up directors as the source of an initial judgment about a proposed transaction, and thereby, efficiently and appropriately, set up in stockholders a reasonable reliance on the directors' recommendation. n327 The disinterested aspect of the matter, however, completely eliminates a central concern of fiduciary doctrine, namely the handling of conflicts of interest. n328

Indeed, some commentators have suggested that disclosure obligations in this context are not even properly described as "fiduciary," but rather as based on ordinary tort principles of deceit or negligence. n329 This effort to differentiate the principles underlying what are traditionally considered the duties of loyalty and care is [*1160] helpful, particularly since it exposes the close analogy between the tort of negligent misrepresentation and the fiduciary disclosure duty of disinterested directors when they recommend stockholder action. n330 It must be acknowledged, though, that there is simply too much history to conclude that the duty of care in the management of trust affairs lacks any fiduciary content. n331 Moreover, to say that a disinterested director's duty of disclosure to stockholders is not a fiduciary duty could rule out the use of a charter provision to eliminate damages liability for breach of that duty. n332

In all events, reliance on a person possessed of superior information and acting as an adviser has persistently been characterized as one model of fiduciary relationship. n333 This model does not ordinarily apply to corporate directors, who are not generally considered to be agents for stockholders, discharging their ordinary management responsibilities subject to the direct control of stockholders as principals. n334 The situation is different, however, where directors counsel stockholders with respect to actions as to which stockholders do have decisionmaking power. Where such power--approval of a merger, or sale of stock in a tender offer, for example--is exercised by stockholders following a recommendation or advice by directors, [*1161] the analogy to the agency relationship and its concomitant fiduciary disclosure obligations is more forceful. n335

Moreover, to the considerable extent that information gathered in the management of the corporation can be considered a corporate asset subject to the directors' management responsibilities, n336 it can be said that the directors' duty of care in presenting a recommendation for stockholder action requires management of that information for the benefit of the stockholders. That is, directors should disseminate such information where it is of material significance to the stockholders' decision and the utility of the information to stockholders is not outweighed by harm from disclosure. n337

Attempting to describe the disinterested director's disclosure duty as a subset of the traditional duty of care, however, reveals a striking, although not necessarily grating, incongruity with traditional due care jurisprudence. A rational decision by disinterested, duly informed directors in the management of the business affairs of the corporation is ordinarily thought to be beyond the realm of judicial intervention. n338 In contrast, whether a fact is material and must be disclosed to stockholders is not a matter on which the courts have given any deference, presumptive or otherwise, to the business judg- [*1162] ment of management responsible for preparing proxy statements or similar disclosure documents. n339

Thus, although courts purport to disavow any role in second-guessing disinterested business decisions, they do not shrink from determining de novo whether a fact is significant enough to be considered material to a business decision by stockholders. n340 The judicial role in evaluating whether directors have fulfilled a recommendation duty of disclosure, then, is considerably more active than the role adopted in reviewing, under the rubric of the duty of care, the fulfillment of other management fiduciary responsibilities. n341

To view the duty of disclosure of disinterested directors entirely as the product of the duty of care, moreover, leaves one further analytical loose end, best illustrated by a variation of the hypothetical situation discussed in introducing this article. n342 Assume that plaintiff's counsel discovers the arguably material omission in time to present an application for a preliminary injunction. As Chancellor Allen observed in Anderson Clayton, n343 it seems most likely that a court would enjoin the transaction, pending curative disclosure to stockholders, upon finding that existing disclosures are materially deficient, even though the directors' failure to disclose was the product of informed deliberation. n344 Yet, in the absence of any director conflict of interest, and given the exercise of due care in preparing the merger proxy material, one would ordinarily conclude that there could be no issue of breach of either the duty of loyalty or the duty of care.

On what theory of liability, then, would such a preliminary injunction rest? n345 The only intellectually satisfying answer is some strict duty of disclosure, akin to that posited for trustees, n346 that can [*1163] be breached despite good faith, disinterest and due care. As anyone contemplating the contours of any such fiduciary duty must inevitably observe, however, to say that there is a fiduciary duty only begins the analysis. n347

To understand a fiduciary recommendation duty of disclosure, one must at the outset consider the limited scope of that duty. The duty is an obligation to use reasonable care in presenting a recommendation for stockholder action and in gathering and disseminating corporate information in connection with that recommendation. The tort doctrine of negligent misrepresentation is powerfully analogous; it prescribes that one who "in the course of his business" negligently supplies false information "for the guidance of others" is liable for pecuniary loss caused by justifiable reliance upon that information. n348 The information supplier's duty extends, however, only to the "limited group of persons for whose benefit and guidance he intends to supply the information," and engenders liability only "in a transaction that he intends the information to influence." n349 Just so, a director, when he recommends stockholder action, is acting "in the course of his business" to supply information "for the guidance of others," namely the "limited group" consisting of the stockholders, with respect to "a transaction that he intends the information to influence." n350

Accordingly, the director's duty in the recommendation context is not discharged merely by presenting the facts known to her personally. As under the negligent misrepresentation formulation requiring that the provider of information "exercise reasonable care or competence in obtaining or communicating the information," n351 the presentation of corporate information accompanying a recommendation to stockholders is a management function which must be discharged through reasonable steps to assure that material information is gathered from the corporate officers and employees reasonably likely to [*1164] possess such information. n352 As a corollary, of course, a director does not fail to discharge his recommendation disclosure duty if, after taking such steps, a material fact fails to come to light because of neglect or mistake on the part of an employee or agent to whom some portion of the information gathering task has been reasonably delegated. n353

These considerations of fiduciary doctrine, and the doctrine of negligent misrepresentation they parallel, also shed light on the questions of who owes the recommendation disclosure duty, when it is owed, what disclosure it mandates, and what remedies exist for its violation. The balance of this section addresses those now familiar questions.

1. Who Owes the Recommendation Duty of Disclosure?

As with the ratification and stock purchase disclosure duties discussed in previous sections, n354 identifying the fiduciary rationale for the duty identifies those who owe the duty. Since the exercise of the management function of making a recommendation of an action, or inaction, to stockholders activates fiduciary responsibilities, those who are responsible for and make the recommendation--the directors of the corporation--owe the duty of disclosure. n355 [*1165]

2. When Does the Recommendation Disclosure Duty Arise?

Again, the fiduciary rationale answers the question. As stated repeatedly in the Delaware cases, "the obligation attaches to proxy statements and any other disclosures in contemplation of stockholder action" n356 --that is, when the directors make a recommendation that the stockholders vote, sell, not sell, or otherwise take action in regard to their shares. The disclosure obligation may thus attach in the context of the election of directors, at least where the directors recommend and solicit stockholder action--voting for their nominees--that importantly affects the management of the corporation.

Fiduciary analysis, however, suggests several limitations on the scope of the recommendation disclosure duty. First, there is a legitimate management role to be played by directors in determining whether disclosure of even material information should be limited or dispensed with altogether in connection with a recommendation to stockholders, where public disclosure of such information might cause harm to the interests of the corporation and its stockholders that would outweigh the benefits of disclosure. Confidential information about a mineral discovery, to take a familiar example, n357 might be highly material to a board of directors' recommendation of a merger in which stockholders receive the acquiring firm's stock. Yet a disinterested board must have some authority to make a judgment that public disclosure of the discovery would be inadvisable in light of the potential benefits of secrecy. In a closely held company, there may be practical ways, such as the execution of confidentiality agreements, to resolve the competing interests of disclosure to stockholders and avoidance of injurious publicity. n358 Where such accommodation is impossible as a practical matter, an informed director determination that the likely harm from disclosure outweighs the benefit should [*1166] preclude director damages liability for nondisclosure of even material information.

Fiduciary analysis suggests another potential limit to the recommendation duty of disclosure. Since that duty is premised upon the recommendation by directors who have an informational advantage over dispersed, disaggregated stockholders who necessarily rely on the directors' superior informational resources, it is necessary to examine, particularly in the case of a closely held company, whether and to what extent that informational advantage truly exists. A stockholder may at times have information, or at least access to information, equivalent to that of the board of directors. n359 Where the informational advantage does not exist, the rationale for application of a fiduciary recommendation disclosure duty vanishes.

Finally, fiduciary analysis suggests why the recommendation disclosure duty should not have been considered applicable to the directors in Stroud at all. What sets up the fiduciary duty is the reliance by stockholders upon the directors in regard to the latter's recommendation of an act that ultimately rests on the volition of the stockholders. Where that potential for stockholder volition is absent or necessarily irrelevant to determining the outcome of events--as in Stroud, where the challenged charter amendments would have been adopted in any event on the strength of the majority block of stock owned by the directors--there is simply no occasion for reliance by stockholders on the directors' recommendation, and no reason to apply a fiduciary recommendation disclosure duty. n360 [*1167]

3. Does the Recommendation Disclosure Duty Affirmatively Require Disclosure of Material Facts, or Merely Avoidance of Material Misrepresentation or Omission?

One must observe preliminarily, again, that this question is largely academic in regard to publicly held companies, since federal law prescribes extensive affirmative disclosure obligations when directors make recommendations in the form of proxy statements or responses to tender offers. n361 As observed in regard to duty of loyalty cases involving public companies, n362 then, the claims in the recommendation disclosure duty area have involved questions of material omission. n363 In this regard, at least, the law of fiduciary duty does little more than what the law of torts accomplishes. It imposes upon the director, when making a recommendation for stockholder action, a duty to use reasonable care to avoid the disclosure of false information and to disclose to the stockholders information necessary to prevent a partial or ambiguous statement from being materially misleading. n364 [*1168]

The academically--and on rare occasion, as in Stroud, practically--more interesting question is whether the fiduciary recommendation disclosure duty is inherently affirmative as well, requiring directors to disclose information material to the recommendation regardless of whether some independent body of law, like the federal securities laws, requires such disclosure. Fiduciary theory suggests that the duty is indeed affirmative. The fiduciary duty and relationship exist because the directors, entrusted with authority over and responsibility for the handling of material corporate information, recommend a course of action or inaction to stockholders who as a result reasonably rely on the directors in making their decision. A rule that eliminated affirmative fiduciary disclosure obligations altogether would, in the absence of some independently derived affirmative disclosure duty, leave disaggregated and non-managing stockholders with the responsibility either to vote or otherwise act in the dark, or gather pertinent information themselves. The outcome of either choice could not be considered efficient. Clearly, the efficient approach is for those who are charged with management responsibility and who make the recommendation in question to provide what material information they reasonably can to the stockholders in connection with their decision. n365

4. What Are the Remedies for Breach of the Disclosure Duty?

If there is an area in which the developing law of fiduciary disclosure duty is in particular need of restraint, it is in regard to the identification of remedies available for failure to fulfill the recommendation disclosure duty. In Arnold, the Delaware Supreme Court made great progress in clarifying that exculpatory charter provisions can preclude an award of monetary damages as a remedy for disinterested [*1169] breach of the recommendation disclosure duty. n366 More progress, however, should be made.

The analysis of remedies should proceed flexibly and with attention to variation in the social interests at stake in the diverse contexts in which directors' disclosure duties have been identified. n367

It may be useful to place upon directors, as central repositories and managers of corporate information, the duty to gather and present material information when they recommend action to the stockholders. To impose too high a cost and risk upon directors discharging that responsibility, however, would be counterproductive. n368 A disinterested director cannot be an insurer that all material information is presented, any more than a disinterested director can be expected to insure that a managerial decision will not lead to loss to the corporation. n369

Holding a disinterested director strictly liable in damages for a failure, revealed as such only with hindsight, to disclose a material fact in connection with a recommendation to stockholders has but one conceivable precedential underpinning: Smith v. Van Gorkom. n370 This Article argues, however, that if Van Gorkom is construed to impose upon disinterested directors personal liability for damages for a non-negligent failure to disclose material facts, it is an "outlier," n371 and that such liability is insupportable in fiduciary theory. Indeed, under the federal proxy regulations, adopted to promote disclosure of material facts as an independent legislative objective, n372 damages liability must be predicated upon some showing of culpability. n373 Even under the law of trusts--which is surely at least, if not more, demanding than the law of corporate director fiduciary duties n374 --a trustee, even if he ought to perform a certain function in acting as trustee, is not [*1170] liable in damages or subject to surcharge if his failure to perform that function is not the result of lack of reasonable care. n375 Hence, a view that any failure to disclose a material fact necessarily requires a remedy in damages is simply too dogmatic and inflexible to be sustained. n376

These introductory thoughts suggest what remedies can be considered appropriate for a failure to fulfill the fiduciary recommendation disclosure duty. First, proof of such a failure before the stockholder action is taken may justify a preliminary injunction, subject to ordinary equitable considerations such as the threat of countervailing harm from granting the injunction, and narrowly tailored to secure corrective disclosure. n377 Second, if equitable considerations warrant, proof of such a failure even after the stockholder action is taken could justify rescission of that action--although intervening rights, particularly in the case of sales of stock to a third party or the mingling of assets following a merger, may frequently make rescission impossible as a practical matter. n378 Indeed, in an appropriate case, rescission of [*1171] an election of directors might be warranted, although experience with common law regulation of proxy contests n379 suggests that such relief is likely to be rare indeed. Courts are likely to demand a greater than usual showing of materiality, i.e., proof of a likelihood that the election was affected by the nondisclosures at issue, n380 since (1) election contestants presumably identify and point out their opponent's most significant misstatements or omissions; n381 and (2) there is usually only a relatively short time before the stockholders will have another opportunity, at the following annual meeting of stockholders, to vote again. n382

A third potential remedy, money damages, may be appropriate post hoc, but only where the disclosure shortcoming is attributable to the requisite director negligence, and subject further to preclusion by charter provision, where authorized. n383 Moreover, since the fiduciary theory upon which the recommendation duty of disclosure rests is equivalent in substance to the basis for liability in tort for negligent misrepresentation, two further limitations on the reach of any potential damages claim emerge: (1) damages are limited to loss actually suffered, and do not extend, in this disinterested context, to "rescissory" damages; and (2) damages can be awarded only upon a showing of reliance, that is, that the nondisclosure proximately caused the action giving rise to the stockholders' loss. n384 This Article [*1172] contends, therefore, that any "virtual per se rule of damages for breach of the fiduciary duty of disclosure" must be limited to the context where it was first identified, namely a transaction assumed to involve self-dealing by a controlling stockholder. n385 No such rule can plausibly be said to exist for breach of a disinterested recommendation duty of disclosure. Any view that tort principles requiring proof of pecuniary loss do not apply to claims of breach of fiduciary duty by disinterested directors must be viewed as out of step with fundamental fiduciary principles. n386

This outline of potential remedies inevitably prompts resort to the maxim that equity will not suffer a wrong without a remedy. n387 It might be argued, after all, even acknowledging director disinterest and due care, that a failure to disclose a material fact, as required by the fiduciary recommendation disclosure duty, cannot go unremedied simply because that failure is only identified by the court after it has become too late to grant preliminary injunctive relief or rescission. n388 This argument, however, misconceives the nature of the fiduciary duty in question. The "wrong" does not exist solely by virtue of a failure to disclose a material fact. In the absence of lack of care in gathering and presenting material information, there simply is no [*1173] fiduciary "wrong" in this context at all. n389 If it seems incongruous, then, that a preliminary injunction could be granted to permit curative disclosure despite director disinterest and due care, one can look at the case law to see that federal courts have long acknowledged that a plaintiff may seek injunctive relief to cure a disclosure failure, while denying to that same plaintiff a damages remedy for the same disclosure failure. n390 Any superficial lack of logic in this approach is amply offset by a practical appreciation of the relative intrusiveness of the preliminary injunction remedy as compared to the post hoc damages remedy.

E. Other Public Statements by Corporate Fiduciaries

Finally, fiduciary theory illuminates the last area in which a fiduciary disclosure duty has been suggested: public statements not intended on their face to elicit or counsel stockholder action. In this context, this Article contends, there is no fiduciary relation at stake at all. At most, directors and officers who issue press releases or other public corporate statements have the market generally, and not the stockholders, as ordinarily intended objects or beneficiaries of the information. n391 The directors have no recognized function under state [*1174] corporate law to manage information so that one segment of the market, existing stockholders, can make buy/sell or other stock-related decisions more intelligently than nonstockholders. Nothing in the law sets up directors as objects of stockholder reliance or sources of recommendations to stockholders, from which an all-encompassing fiduciary duty of continuous disclosure might be inferred. To the contrary, to the extent that law or stock exchange rules require public disclosure where stockholder action is not sought, the regulatory goal is market regulation and enhancement, not oversight of the director/stockholder relationship. n392

There is certainly no basis to quarrel with the application of conventional tort doctrine to public statements made by directors, or by anyone else for that matter. A knowingly incorrect statement or misrepresentation by omission constitutes an actionable wrong where it is detrimentally relied upon by a stockholder or anyone else foreseeably affected by it. n393 To create a fiduciary duty to stockholders in this context, however--and it would be creating one n394 --would signifi- [*1175] cantly rewrite the corporate contract, effectively substituting state law for what is historically and far more properly a federal matter: the regulation of disclosure in the interest of facilitating interstate markets for securities. n395 [*1176]

This approach in no way leaves stockholders unprotected against public misrepresentations by management; it simply leaves such protection a matter addressed by other bodies of law. A viable claim under the knowing misrepresentation fiduciary theory suggested in Marhart would ordinarily support a damages claim under Rule 10b-5, n396 and for a class that included all purchasers or sellers, and not just stockholders at the time of the challenged nondisclosure. n397 The only persons for whom the Marhart fiduciary duty theory could afford a basis for recovery not available under Rule 10b-5 are those who were stockholders at the time of the material nondisclosure and who claim that they would have bought more shares, or sold their shares, but for the material nondisclosure. Yet to allow recovery of damages by such persons would run squarely afoul of the problems of speculative proof that persuaded the United States Supreme Court to impose a purchaser/seller requirement in damages actions under Rule 10b-5. n398

It is only partly reassuring that Marhart only applies a duty of completeness, and does not purport to create an affirmative duty of disclosure. n399 Limiting the fiduciary duty identified in Marhart to a duty of completeness, however, seems artificial. If a fiduciary duty exists to ensure that disclosures made by management to the general public are sufficient to inform the stockholders fully in their decisions to buy or sell shares in the market, then, as has been suggested with some force, it "does not follow analytically" to limit that duty to one of completeness, rather than extend it to require affirmative disclosures. n400 Yet to require affirmative disclosures in lieu of silence would take the courts into areas of state law into which, at least thus far, they have consistently declined to go. n401 At the very least, such a step should proceed from a firm basis in fiduciary principles. No such basis, however, has been suggested. [*1177]

Marhart, then, was a toe unnecessarily dipped in very deep, murky legal waters in which state fiduciary doctrine had never previously swum. Enthusiasm for the moral obligations of corporate fiduciaries should not obscure the radical character of that jurisprudential step. This Article contends that the law of fiduciary disclosure duty should remain solidly footed in its traditional contexts outlined above.

VI. Recapitulation

Scattered judicial and scholarly treatment has left the disclosure obligations of corporate fiduciaries unsettled, the occasional victim of a judicial willingness to follow the exhortations of fiduciary rhetoric into contexts in which the rationales of fiduciary obligation do not support the existence of such a duty or the remedies suggested for breach of such a duty. A reconsideration of the historical and varied contexts of fiduciary disclosure duties and an examination of how those contexts largely dovetail with generally accepted rationales of fiduciary doctrine should contribute to a more precise and justifiable development and application of fiduciary disclosure duties in future cases.

Where the fiduciary rationales operate most vigorously and appropriately--that is, where corporate directors seek stockholder action approving or effecting transactions in which the directors' conflicting personal interests are served--the courts have appropriately imposed affirmative fiduciary disclosure obligations and backed them up with the broadest range of equitable remedies. Where directors are disinterested and merely serve a recommendation function, an affirmative disclosure duty akin to the duty of care and the tort of negligent misrepresentation exists to help assure that stockholders are provided with corporate information material to the recommendation. The remedies for breach of that duty, however, are constrained in the same way as the remedies for breach of the traditional duty of care, or the analytically equivalent tort duty to avoid negligent misrepresentation. The damages remedy is limited to cases of director neglect and to losses actually incurred by stockholders in reliance on the disclosure failure. Finally, where disinterested directors fail to disclose information that is material to the market generally, but not to any recommendation made to the stockholders by the directors, there is no fiduciary rationale that warrants imposition of a fiduciary disclosure duty for the benefit of the portion of the market that happens to own stock already. [*1178]

From these considerations, future development of the case law, particularly in Delaware, could be clarified and improved by:

* Clear recognition of the context--self-dealing versus disinterested; recommending stockholder action or merely providing information to the market generally--in which the fiduciary disclosure duty is invoked;

* Recognition that when disinterested directors recommend stockholder action, they can be held personally liable in damages for a failure to disclose a material fact to stockholders only where that failure is the product of culpable negligence in gathering and presenting information to stockholders;

* Recognition that, as under the doctrine of negligent misrepresentation, stockholders may not recover damages from disinterested directors, based on a claimed nondisclosure in connection with a director recommendation of stockholder action, unless the stockholders can establish reliance upon the claimed nondisclosure; and

* Recognition that in claims against disinterested directors of a material nondisclosure in connection with a recommendation of stockholder action, there is no per se rule of damages, and recovery of damages depends upon proof of actual loss.

FOOTNOTES:

n1 *15 U.S.C. sections 78a* et seq. (1994 ed.). See generally Louis Loss and Joel Seligman, Fundamentals of Securities Regulation (Little, Brown, 3d ed. 1995); Thomas Lee Hazen, The Law of Securities Regulation (West, 3d ed. 1995). Directors are responsible under the Securities Exchange Act of 1934 for the fulfillment of the Act's disclosure obligations, at least insofar as they solicit proxies, *Gould v. American-Hawaiian Steamship Co., 351 F. Supp. 853, 856, 858 (D. Del. 1972),* vacated on other grounds, *535 F.2d 761 (3d Cir. 1976);* Edward Brodsky and M. Patricia Adamski, Law of Corporate Directors and Officers section 15:14 (1995 Supp.), or actively supervise the preparation of periodic disclosures by the corporation. *15 U.S.C. section 78*(t); *Wool v. Tandem Computers, Inc., 818 F.2d 1433, 1440-42 (9th Cir. 1987).* Compare *Hemming v. Alfin Fragrances, Inc., 690 F. Supp. 239, 245 (S.D.N.Y. 1988)* (holding that one's mere status as a director or officer is an insufficient basis for liability as a "controlling person" under section 20(a) of the Securities Exchange Act of 1934).

n2 See, for example, *Gaffin v. Teledyne, Inc., 611 A.2d 467, 472 (Del. 1992)* (discussing equitable fraud as a theory of liability for material omissions in a corporation's offer to purchase its own outstanding shares); *Alfus v. Pyramid Technology Corp., 745 F. Supp. 1511, 1523-24 (N.D. Cal. 1990)* (evaluating stock purchasers' claim of negligent misrepresentation against the issuer's directors); *General Inv. Co. v. American Hide & Leather Co., 97 N.J. Eq. 230, 127 A. 659, 662 (N.J. Chanc. 1925)* (invoking both fraud and trust concepts to impose upon directors a duty of disclosure in solicitation of proxies).

n3 Indeed, it was the perceived inability of state law to provide sufficient information to the securities markets that led to the enactment of comprehensive federal securities legislation. See, for example, Joel Seligman, The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance (Houghton Mifflin, 1982); Manuel F. Cohen, Federal Legislation Affecting the Public Offering of Securities, *28 Geo. Wash. L. Rev. 119, 125 (1959)* ("Common law notions of culpable deceit and the mesh of 'Blue Sky' controls were not effective deterrents" to "increasing recklessness in the flotation of securities . . . in the period prior to 1929."). This rationale, however, has been recently criticized. See Frank H. Easterbrook and Daniel R. Fischel, The Economic Structure Of Corporate Law 285-300 (Harvard U., 1991) (suggesting, as an alternative rationale for a national antifraud rule, the elimination of the necessity for multiple litigation forums for each fraudulent interstate stock issuance and criticizing customary rationales for mandatory disclosure requirements). In any event, dissatisfaction with state law also has been identified as the motivation for regulation of proxy solicitation under section 14(a) of the Securities Exchange Act of 1934:

Notwithstanding the basic importance of the solicitation of proxies in determining the destiny of corporate management and affairs, and the temptations and abuses which almost inevitably accompany unrestricted power, the states did virtually nothing to cope with the problem. Prior to 1934, the managements of many corporations solicited proxies and perpetuated themselves in office without furnishing to the stockholders the most elementary facts concerning the corporation and the matters on which the stockholders were expected to vote. In many cases, the stockholders were not even informed of the names of the proposed directors or their connection with or stockholdings in the cor-poration.

Edward Ross Aranow and Herbert A. Einhorn, Proxy Regulation: Suggested Improvements, *28 Geo. Wash. L. Rev. 306, 306 (1959).*

n4 See Parts III and IV.

n5 *606 A.2d 75 (Del. 1992).*

n6 *Id. at 84.*

n7 Marhart, Inc. v. Calmat Co., *18 Del. J. Corp. L. 330, 336 (Del. Chanc. 1992).* See also *Ciro, Inc. v. Gold, 816 F. Supp. 253, 266 (D. Del. 1993)* ("It is also well-established Delaware law that once directors voluntarily undertake to make certain disclosures to the stockholders, they are obligated, under the so-called duty of complete candor, to disclose all material facts. This duty arises even when voluntary disclosure is made by the directors and no shareholder action in reliance thereon is requested or contemplated."); *Kahn v. Roberts, 1994 WL 70118*, *2 (Del. Chanc. Feb. 28, 1994) ("Even, as here, where stockholder approval was not sought or needed, directors who decide voluntarily to disclose information relating to a corporate transaction to stockholders are subject to the duty of full and frank disclosure of all material facts."), aff'd, *1996 WL 438724* (Del. July 25, 1996).

n8 See notes 18-23 and accompanying text.

n9 See note 24 and accompanying text.

n10 See note 25 and accompanying text.

n11 See generally Robert A. Ragazzo, Unifying the Law of Hostile Takeovers: The Impact of QVC and Its Progeny, *32 Houston L. Rev. 945 (1995);* Paul L. Regan, The Unimportance of Being Earnest: Paramount Rewrites the Rules for Enhanced Scrutiny in Corporate Takeovers, *46 Hastings L. J. 125 (1994);* Lawrence A. Cunningham and Charles M. Yablon, Delaware Fiduciary Duty Law After QVC and Technicolor: A Unified Standard (and the End of Revlon Duties?), *49 Bus. Law. 1593 (1994);* Marcel Kahan, Paramount or Paradox: The Delaware Supreme Court's Takeover Jurisprudence, *19 J. Corp. L. 583 (1994);* Stephen Fraidin and Jon D. Hanson, Toward Unlocking Lockups, *103 Yale L. J. 1739 (1994);* Kenneth J. Nachbar, Revlon, Inc. v.

MacAndrews & Forbes Holdings, Inc.--The Requirement of a Level Playing Field in Contested Mergers, and Its Effect on Lock-Ups and Other Bidding Deterrents, *12 Del. J. Corp. L. 473 (1987).*

n12 See Committee on Corporate Laws, Section of Business Law of the American Bar Association, Corporate Director's Guidebook 49-50 (2d ed. 1994) ("Directors should be particularly attentive to the procedures followed in preparing the corporation's proxy statements and should review them carefully before they are disseminated, to corroborate that there are no material misstatements or omissions.").

n13 See, for example, *Stroud, 606 A.2d at 85.* Whether and to what extent this fiduciary disclosure duty exists in the absence of proxy solicitation, and why the solicitation of proxies should alter the substance of the fiduciary duty owed, are matters discussed in Part IV.C.1.

n14 *Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944 (Del. 1985)* (adopting the materiality standard articulated by the United States Supreme Court in *TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).*

n15 See, for example, *TSC Industries, 426 U.S. at 444; Mills v. Electric Auto-Lite Co., 396 U.S. 375, 381 (1970); J.I. Case Co. v. Borak, 377 U.S. 426, 431 (1964).*

n16 Damages liability in a private action under SEC Rule 14a-9 for material omissions in a proxy statement is generally understood to require a showing of culpability at least amounting to negligence. *Shidler v. All American Life & Financial Corp., 775 F.2d 917, 927 (8th Cir. 1985); Gould v. American-Hawaiian Steamship Co., 535 F.2d 761, 777-78 (3d Cir. 1976);* Brodsky and Adamski, Law of Corporate Directors section 15:18 (cited in note 1).

n17 See *Stroud, 606 A.2d at 86-87* (stating that Delaware law adopts the same disclosure standard as federal law).

n18 See, for example, *Arnold v. Society for Savings Bancorp, Inc., 678 A.2d 533 (Del. Chanc. 1996); Williams v. Geier, 671 A.2d 1368, 1379 (Del. 1996); In re Santa Fe Pacific Corp. Shareholder Litigation, 669 A.2d 59, 66 (Del. 1995); Arnold v. Society for Savings Bancorp, Inc., 650 A.2d 1270, 1277 (Del. 1994); Zirn v. VLI Corp., 621 A.2d 773, 778 (Del. 1993); Stroud, 606 A.2d at 84; Shell Petroleum, Inc. v. Smith, 606 A.2d 112, 114-15 (Del. 1992); Smith v. Van Gorkom, 488 A.2d 858, 890 (Del. 1985); Barkan v. Amsted Industries, Inc., 567 A.2d 1279, 1288 (Del. 1989);* Lewis v. Leaseway Transportation Corp., 1990 Fed. Secur. L. Rptr. (CCH) paragraph 95,275 at 96,268 (Del. Chanc. May 16, 1990); *Blasius Industries, Inc. v. Atlas Corp., 564 A.2d 651, 659 n.2 (Del. Chanc. 1988);* Glassman v. Wometco Cable TV, Inc., *11 Del. J. Corp. L. 649, 656 (Del. Chanc. 1985).*

n19 *519 A.2d 669 (Del. Chanc. 1986).*

n20 *Id. at 675.*

n21 Id. See also *Estate of Detwiler v. Offenbacher, 728 F. Supp. 103, 150 n.18 (S.D.N.Y. 1989)* (noting that the business judgment rule is inapplicable to allegations of misrepresentations or omissions in a proxy statement); *Kahn v. Lynch Communication Systems, Inc., 669 A.2d 79, 88 (Del. 1995)* (holding that materiality is "determined from the perspective of the reasonable shareholder, not that of the directors or other party who undertakes to distribute information"); *Zirn, 621 A.2d at 779-80* (holding that the materiality of an omission should be determined by applying a broad objective standard); Lewis, 1990 Fed. Secur. L. Rptr. paragraph 95,275 at 96,268 (holding that the business judgment rule has no applicability to the question of whether shareholders have been provided with appropriate information to make an informed choice); In re Tri-Star Pictures, Inc. Litigation, 1990 Fed. Secur. L. Rptr. (CCH) paragraph 95,319, at 96,526, 96,531 (Del. Chanc. June 14, 1990) (holding that the business judgment rule does not apply to disclosure issues).

n22 Commentators have remarked upon the absence of any recitation of a culpability element of a breach of the fiduciary duty of disclosure. See, for example, J. Robert Brown, Jr., The Regulation of Corporate Disclosure section 9.03[4] at 9-20 (2d ed. 1995 Supp.) ("Delaware cases have not explicitly imposed a state of mind requirement for violations of the duty of candor."); Donald E. Pease, Delaware's Disclosure Rule: The "Complete Candor" Standard, Its Application, and Why Sue in Delaware, *14 Del. J. Corp. L. 445, 486-87 (1989)* (noting that "under the Delaware cases . . . the plaintiff need not prove that the flawed disclosure was caused by either scienter or negligence" and concluding that "Delaware has a strict liability standard in the disclosure area . . ."). Brown treads with caution on the point, however, noting the "possibility . . . that the courts will specifically confront the issues and impose a state of mind requirement." Brown, Corporate Disclosure section 9.02 at 9-21 (cited in this note).

n23 *Anderson Clayton, 519 A.2d at 675.* Chancellor Allen observed that there has been no case in which:

A truly important piece of information, within the knowledge of the board, had not been disclosed, but the court nevertheless denied an application for a preliminary injunction on the basis that while the Court found the information highly material, reasonable men could differ on the subject and the board's decision not to disclose, having been made in good faith, should be deferred to. I doubt that that is the law.

Id.

See also *Zirn, 621 A.2d at 779* ("A material omission is not rendered immaterial simply because the party making the omission honestly believes it insignificant.").

n24 *In re Tri-Star Pictures, Inc., 634 A.2d 319, 327 n.10 (Del. 1993)* (citing *Van Gorkom, 488 A.2d at 858; Weinberger v. UOP, Inc., 457 A.2d 701, 701 (Del. 1983)).*

n25 *Tri-Star Pictures, 634 A.2d at 333.*

n26 See notes 267-69 and accompanying text.

n27 See *8 Del. Code Ann. section 141(e)* (1994). See also Model Bus. Corp. Act Ann. section 8.30(b) (Prentice Hall, 3d ed. 1996 Supp.).

n28 A recent opinion of the Delaware Supreme Court notes, without analysis, that the "duty of disclosure" is "an obligation that has been characterized as a derivative of the duties of care and loyalty." *Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1166 (Del. 1995).*

n29 Although the Delaware statute permits elimination, by charter provision, of monetary liability of directors for breach of fiduciary duty, it does not allow elimination of liability for breach of the duty of loyalty. *8 Del. Code Ann. section 102(b)(7).* In a 1993 opinion, the Delaware Supreme Court found such an exculpatory provision insufficient to preclude monetary liability for breach of the fiduciary duty of disclosure. *Zirn, 621 A.2d at 783* (discussed at Part IV.C.2.). But see *Arnold, 650 A.2d at 1287* (holding that the statute expressly protects directors from liability for breach of the fiduciary disclosure requirements) (discussed at Part IV.C.3).

n30 See generally R. Franklin Balotti and Jesse A. Finkelstein, 1 The Delaware Law of Corporations and Business Organizations section 22.10 (Aspen Law & Business, 2d ed. 1996 Supp.); Dennis J. Block, Nancy E. Barton, and Stephen A. Radin, The Business Judgment Rule: Fiduciary Duties of Corporate Directors 197-215 (Prentice Hall, 4th ed. 1993 and 1995 Supp.); Brown, Corporate Disclosure section 9.02 at 39 (cited in note 22); Lewis D. Solomon, Corporations Law and Policy, Materials and Problems 890-96 (3d ed. 1994); David A. Drexler, Delaware Corporation Law and Practice paragraph 15.07A (1996 Supp.); Ernest L. Folk III, Rodman Ward Jr., and Edward P. Welch, Folk on the Delaware General Corporation Law section 212.4.2 (Little, Brown, 3d ed. 1992 and 1996 Supp.); Dale A. Oesterle and Alan R. Palmiter, Judicial Schizophrenia in Shareholder Voting Cases, *79 Iowa L. Rev. 485, 565-70 (1994);* Pease, *14 Del. J. Corp. L. at 445* (cited in note 22); Steven J. Rothschild and Keith R. Sattesahn, "All Germane Facts With Complete Candor"--Delaware's Disclosure Duty, in Delaware Law for Corporate Lawyers--Recent Developments 323-52 (Practicing Law Institut, 1985).

n31 See *Restatement (Second) of Torts section 551* cmt. e (1977) ("It is not within the scope of this Restatement to state the rules that determine the duty of disclosure which under the law of business associations the directors of a company owe to its shareholders.").

n32 Principles of Corporate Governance: Analysis and Recommendations sections 5.02, 5.04 (ALI 1994) ("ALI Principles") (defining director disclosure obligations in situations involving self-dealing and use of material inside information in transactions in the corporation's stock).

n33 See, for example, Balotti and Finkelstein, Delaware Law of Corporations sections 22.10(C), 22.11 (cited in note 30); Block, Business Judgment Rule at 199-208 (cited in note 30); Brown, Corporate Disclosure sections 9.03[3], [5] (cited in note 22); Folk, Ward, and Welch, Delaware General Corporation Law sections 212:30-:39 (cited in note 30); Pease, *14 Del. J. Corp. L. at 458-476* (cited in note 22); Rothschild and Sattesahn, Delaware's Disclosure Duty in Delaware Law for Corporate Lawyers at 335-352 (cited in note 30).

n34 The tendency to view fiduciary disclosure duty in this unitary fashion finds considerable support in the case law. Recent treatment of the duty by the Delaware Supreme Court identifies a "duty of disclosure" as a distinct legal obligation which is "derivative of the duties of care and loyalty," but apparently distinct and separate from those duties. *Cinerama, 663 A.2d at 1166; Zirn, 621 A.2d at 778.* Moreover, suggestions that the duty should vary according to the character of the transaction have met with judicial criticism. See, for example, *Barkan, 567 A.2d at 1288* (rejecting a test that would define materiality more stringently in cases of director self-interest). But see Cottle v. Standard Brands Paint, 1990 Fed. Secur. L. Rptr. (CCH) paragraph 95,306 (Del. Chanc. Mar. 22, 1990) (holding that directors' opinions as to adequacy of self-tender offer are immaterial, particularly since the transaction does not eliminate stockholders' equity interests).

n35 Pease, *14 Del. J. Corp. L. at 447* (cited in note 22) ("Delaware's disclosure standard . . . is known as the rule of 'complete candor.' "); Brown, Corporate Disclosure section 9.01 at 9-3 n.2 (cited in note 22) (stating that although "court terminology has not been so clear," "the duty of candor will encompass any affirmative obligation on the part of a company that arises out of fiduciary obligations to shareholders"); Oesterle and Palmiter, *79 Iowa L. Rev. at 565* (cited in note 30) (discussing the common law duty of "complete candor").

n36 *Stroud, 606 A.2d at 84.* The court noted that "the term 'duty of candor' has no well accepted meaning in the disclosure context. Its use is both confusing and imprecise given the well-established principles and duties of disclosure that otherwise exist. Thus, it is more appropriate for our courts to speak of a duty of disclosure based on a materiality standard rather than the unhelpful terminology that has crept into Delaware court decisions as a 'duty of candor.' " Picking up the hint, Solomon describes a "state law duty of disclosure" owed by corporate fiduciaries. Corporations Law at 890 (cited in note 30).

Whether the substitution of the phrase "duty of disclosure" for "duty of complete candor" has done more for doctrinal clarity than new clothes did for the emperor is unclear. To the extent that Stroud urges adherence to "well-established principles and duties of disclosure that otherwise exist" in corporate law, however, it is entirely consistent with the thrust of this article.

Stroud, 606 A.2d at 84.

n37 The fervent tone and moral quality of discourse on fiduciary duties have been frequently remarked upon and explained as devices to strengthen the efficacy of rules of fiduciary behavior where detection of misbehavior and enforcement through litigation are likely to be erratic.

By obscuring the limits of fiduciary obligations under moralistic rhetoric and by verbally chastising those who are found to have violated the standard, or come close to doing so, the courts seek to maintain the standard by discouraging marginal behavior which might or might not violate it. It is the imprecision of the standard and the fact that there are limitations on its scope which cannot be acknowledged in the judicial formulations that lead the courts to employ excessive rhetorical force in promulgating fiduciary doctrine. Ambiguity breeds vehemence. Further, the knowledge that fiduciary principles cannot be precisely and minutely enforced leads to the use of strong language as a control mechanism.

J. A. C. Hetherington, Defining the Scope of Controlling Shareholders' Fiduciary Responsibilities, *22 Wake Forest L. Rev. 9, 11 (1987).* See also Robert C. Clark, Agency Costs Versus Fiduciary Duties, in John W. Pratt and Richard J. Zeckhauser, eds., Principals and Agents: The Structure of Business 55, 75-76 (Harvard Bus. School, 1991) (noting that in enforcing fiduciary duties, judges "try to create feelings of guilt for violation of duty and rectitude for fulfillment of duty, and even conjure up an aura faintly resembling that which churches try to put around the duties of ministers to their congregations or of parents to their children").

n38 *383 A.2d 278 (Del. 1977).*

n39 *Id. at 281.*

n40 See Part IV.

n41 See id.

n42 See Harper Lee, To Kill A Mockingbird (Lippincott, 1960); Walter Van Tilburg Clark, The Ox-Bow Incident (Readers Club, 1942). The analogy between the evolution from Lynch and the evolution of a lynch mob is obviously imperfect, and it would be foolish to infer that the fiduciary disclosure duty issue has so inflamed the passion of the Delaware courts as to blind them to reason. It would be equally foolish, however, not to acknowledge that rhetoric, on the subject of fiduciary duty or otherwise, may obscure or drive out reasoned analysis.

n43 See Part II.A (discussing 21 Del. Laws 273, section 21 (1899) (repealed in 1967)).

n44 See Part II.B.

n45 See Part III.A.

n46 See Part III.B.

n47 *488 A.2d at 872-73.* That development and the significant Delaware cases following it are explored in Part IV.

n48 See Part V.

n49 Austin Wakeman Scott and William Franklin Fratcher, 2A The Law of Trusts section 170 at 311 (Little, Brown, 4th ed. 1987); J.C. Shepherd, The Law of Fiduciaries 35 (1981). See also Part V.A.

n50 See, for example, *Weinberger, 457 A.2d at 710* (noting that in a self-dealing transaction, the defendant has the burden of establishing the "entire fairness" of the transaction); *Oberly v. Kirby, 592 A.2d 445, 467 (Del. 1991)* (stating that an interested transaction can be upheld if approved by a neutral decision-making body); *Guth v. Loft, Inc., 5 A.2d 503, 512 (Del. 1939)* ("It was incumbent upon [the director] to show that his every act in dealing with the opportunity presented was in the exercise of the utmost good faith to the corporation.").

n51 Shepherd, Law of Fiduciaries at 37-38 (cited in note 49); *Lynch v. Vickers Energy Corp., 429 A.2d 497, 503-04 (Del. 1981).*

n52 See, for example, *Wolf v. Frank, 477 F.2d 467, 477 (5th Cir. 1973)* (refusing to find that the uninformed vote of the shareholders of a corporation constituted ratification); *Wendt v. Fischer, 234 N.Y. 439, 154 N.E. 303, 304 (1926)* (holding that for disclosure to be effective, it must "lay bare the truth, without ambiguity or reservation, in all its stark significance"); *Restatement (Second) Of Trusts section 216(2)* (1957) ("The consent of the beneficiary does not preclude him from holding the trustee liable for a breach of trust, if . . . the beneficiary, when he gave his consent, did not know of . . . the material facts which the trustee knew or should have known and which the trustee did not reasonably believe that the beneficiary knew . . . ."). See also Part III.A.

n53 See note 265.

n54 Scott and Fratcher, 2A Law of Trusts section 170 at 312 (cited in note 49).

n55 See Part III.A.

n56 One example is when the directors recommend that stockholders approve a merger agreement. See Part V.C.

n57 See note 260.

n58 See note 333.

n59 See note 336.

n60 See notes 266-69, 338 and accompanying text.

n61 *Van Gorkom, 488 A.2d at 873.* See also note 267 and accompanying text; William M. Fletcher, 3A Fletcher Cyclopedia of the Law of Private Corporations section 1037 at 44-45 (Callaghan, perm. ed. 1994) (arguing that excessive director liability increases agency costs).

n62 *Cinerama, 663 A.2d at 1148-49,* aff'd, *663 A.2d 1156 (Del. 1995);* ALI Principles section 7.18(a) (cited in note 32).

n63 R. Franklin Balotti and James J. Hanks, Jr., Rejudging the Business Judgment Rule, *48 Bus. Law. 1337, 1342 (1993);* Fletcher, 3A Cyclopedia of the Law of Private Corporations section 1037 at 42 (cited in note 61).

n64 See text accompanying notes 348-50.

n65 For example, in his treatment of the "duty of candor"--probably the most thorough and thoughtful to date--Brown states that "the doctrine does have the potential to revitalize state law in the proxy area . . . . Under the duty of candor, a company may arguably have an affirmative obligation to disclose material developments as they occur." Brown, Corporate Disclosure section 9.02 at 9-28 (cited in note 22). Solomon speculates that "it may be that the duty to disclose applies to all communications by fiduciaries to shareholders, regardless of whether shareholder action is required." Corporations Law at 892 (cited in note 30). See also Oesterle and Palmiter, *79 Iowa L. Rev. at 566* (cited in note 30) ("Shareholders use the 'complete candor' tool principally to challenge (and effectively rewrite) the terms of mergers, reorganizations, and charter amendments--a substitute for fiduciary review on the merits.").

n66 See SEC Rules 14d-9 and 14e-2, *17 C.F.R. sections 240.14d-9* and 240.14e-2 (1996).

n67 21 Del. Laws 273, section 21 (1899), later codified at *8 Del. Code Ann. section 144* (1953) (referred to herein as "former section 144"). See Solomon, Corporations Law at 890 (cited in note 30) ("The Delaware duty of disclosure can be traced ultimately to a now repealed state statute: 8 Del. C. section 144 (1953)."); Brown, Corporate Disclosure section 9.02 at 9-4, 9-28 (cited in note 22) (describing the "duty of candor" as "historically grounded in a state statute," and describing that statute's disclosure requirement as a "relatively sleepy edifice until the 1970s"); Drexler, Delaware Corporation Law paragraph 15.07A at 15-36 (cited in note 30) (noting that prior to Lynch, "the duty of a corporation's management to provide information to stockholders had been measured by a fraud standard . . . [which f]rom 1899 until it was repealed in 1967 . . . had been embodied in the statute itself"); Pease, *14 Del. J. Corp. L. at 448* (cited in note 22) ("Even before any Delaware case stated requirements on disclosure, the General Corporation Law of Delaware (GCL) required accurate information in certain communications to shareholders.").

n68 The statute in question provided:

If the directors or officers of any corporation organized under the provisions of this chapter, shall knowingly cause to be published or give out any written statement or report of the condition or business of the corporation that is false in any material respect, the officers and directors causing such report or statement to be published, or given out, or assenting thereto, shall be jointly and severally, individually liable for any loss or damage therefrom.

21 Del. Laws 273, section 21 (1899).

n69 Marhart, *18 Del. J. Corp. L. at 336* (citing *Kelly v. Bell, 254 A.2d 62, 71 (Del. Chanc. 1969),* for the proposition that "the legal rule announced in section 144 seems to have survived the repeal of the statute" in 1967). For that "rule" to have survived the repeal of the statute, however, it must necessarily have been part of the common law. Ordinarily, "under common law principles all rights, liabilities, penalties, forfeitures and offenses which are of purely statutory derivation and unknown to the common law are eliminated by the repeal of the statute which granted them, irrespective of the time of their accrual." Norman J. Singer, 1A Sutherland Statutory Construction section 23.33 (5th ed. 1993). Yet neither Marhart nor Kelly cites any authority indicating that directors owed a general fiduciary duty to stockholders under common law to disclose all material facts when giving out written statements concerning the business or condition of the corporation.

n70 Marhart, Inc. v. Calmat Co., *18 Del. J. Corp. L. 740, 743 (Del. Chanc. 1992)* ("There is nothing in this Court's earlier decision concerning disclosures to nonstockholders and, as defendants note in their motion for reargument, fiduciary duties run to stockholders, not prospective stockholders.") (citing *Anadarko Petroleum Corp. v. Panhandle Eastern Corp., 545 A.2d 1171 (Del. 1988)).*

n71 The statute provided:

If any certificate made, or any public notice given by the officers of any company in pursuance of the provisions of this act shall be false in any material representation, all the officers who shall have signed the same shall be jointly and severally liable for all the debts of the corporation contracted while they were stockholders or officers thereof.

17 Del. Laws, 147 section 31 (1883). For similar and contemporaneous state statutes, see, for example, *Steam Engine Co. v. Hubbard, 101 U.S. 188 (1879)* (applying Connecticut's statute); Prescott F. Hall, The Law of Massachusetts Business Corporations 302 (3d ed. 1917) (discussing Massachusetts's statute); James B. Dill, The Statutory and Case Law Applicable to Private Companies Under the General Corporation Act of New Jersey and Corporation Precedents 78 (3d ed. 1901) (discussing New Jersey's statute); Frank Hubbard Twyeffort, Business Corporations in New York section 352 at 397-98 (1918) (quoting New York's statute prescribing liability to persons who become stockholders in reliance on false reports)).

n72 *Steam Engine Co., 101 U.S. at 194* (applying Conn. Rev. Stat. section 404 and stating that "statutes of the kind are passed for the benefit of creditors, and their reliance always is upon the officers who are such when they give the credit . . . ."); *Felker v. Standard Yarn Co., 148 Mass. 226, 19 N.E. 220, 221 (1889)* ("No doubt one important reason, perhaps the principal reason, for the statutory provisions, is to enable persons who may have occasion to deal with corporations to ascertain their condition, and their title to credit . . . .").

n73 The statute provided:

Any officer of a corporation who willfully gives a certificate, or wilfully makes an official report, public notice, or entry in any of the records or books of the corporation, concerning the corporation or its business, which is false in any material representation, shall be liable for all the damages resulting therefrom to any person injured thereby; and if two or more officers unite or participate in the commission of any of the acts herein designated, they shall be jointly and severally liable.

Cal. Civ. Code section 316 (West, 1874) (in effect July 1, 1874).

n74 The statute provided:

If any certified report or statement made, or public notice given by the officers of any corporation, shall be false in any material representation, all the officers who shall have signed the same, knowing it to be false, shall be jointly and severally liable for all damages resulting therefrom.

Ill. Rev. Stat. ch. xxxii, section 21 (1872).

n75 21 Del. Laws 273, section 21 (1899).

n76 Although there appear to be no reported Delaware cases under former section 144 involving claims of liability by allegedly defrauded stock purchasers or sellers, a similar statute has provided the basis for such claims. See *Smeland v. Renwick, 50 Cal. App. 565, 196 P. 283, 285 (1920)* (involving a claim against directors by allegedly defrauded purchasers of corporate bonds and common and preferred stock and invoking *Cal. Civ. Code section 316*).

n77 Case law in jurisdictions outside of Delaware held that defrauded purchasers of corporate stock could sue directors and officers directly to recover damages resulting from fraudulent written representations about the corporation disseminated by the directors or officers to the public.

It has often been decided that directors are liable for fraudulent representations as to the financial condition of the company, whereby others are induced to give credit to the company, or to purchase its obligations or shares of its stock. . . . It is not necessary that the misrepresentation be made by the directors directly to the party complaining.

Victor Morawetz, 1 A Treatise on the Law of Private Corporations section 573 (Little, Brown, 2d ed. 1886).

It is hardly necessary to say that a director of a company who knowingly issues or sanctions the circulation of a false prospectus, containing untrue statements of material facts, the natural tendency of which is to mislead and deceive the community, and to induce the public to purchase its stock, is responsible to those who are injured thereby.

Id. section 543 (citing, among other cases, *Morgan v. Skiddy, 62 N.Y. 319, 326 (1875)* (Andrews, J.)).

n78 Indeed, a text written a few years after the 1899 revision annotates the revised Delaware statute with references to case law imposing liability upon stock promoters for material misrepresentations to, or concealment of material facts from, potential subscribers. J. Ernest Smith, The Law of Business Corporations Organized Under the General Corporation Law of the State of Delaware 83-84 (2d ed. 1904).

n79 Securities Act of 1933, *15 U.S.C. sections 77a*-77aa (1994 ed.).

n80 See, for example, Bayless Manning and James J. Hanks, Jr., Legal Capital 91 (Foundation Press, 3d ed. 1990) ("It is a safe generalization . . . that the statutory legal capital machinery provides little or no significant protection to creditors of corporations."); 1 Model Bus. Corp. Act Ann. at 6-218 (noting that the 1980 elimination of capital concepts from the Model Business Corporation Act was "based on the premise that the complex structure of rules established by earlier versions of the Model Act did not provide realistic protection to creditors or senior securities holders").

n81 Thus, as the court noted in Marhart, there is not even any legislative history surrounding the elimination of former section 144 in the 1967 revision of the Delaware General Corporation Law. Marhart, *18 Del. J. Corp. L. at 335*. The extensive volume prepared by the reporter for the revision committee is silent on the failure to carry forward the provisions of former section 144. See generally Ernest L. Folk III, Review of the Delaware Corporation Law (1968).

Only two states retain statutes that make directors or officers liable in damages to persons who rely to their injury upon knowingly false statements in published corporate documents. *Ariz. Rev. Stat. section 10-1631* (West, 1995) (prescribing liability "to a person who has become a creditor or shareholder of the corporation on the faith of the false material representation . . . for all damages resulting"); *Ohio Rev. Code Ann. section*

1701.93 (Page, 1994). Interestingly, the Ohio statute has in recent years served as the basis for imposing personal liability upon corporate officers. See *In re Walsh, 143 B.R. 691, 695-96 (N.D. Ohio 1992)* (refusing to declare a default judgment non-dischargeable under *Ohio Rev. Code Ann. section 1701.93*); *Hinkle v. Sherwood Products, Inc., 13 Ohio App. 3d 414, 469 N.E.2d 869, 870-72 (Ohio Ct. App. 1983)* (holding officer liable to employee for medical costs, due to entry on pay stubs and time cards falsely showing medical insurance coverage).

n82 Model Bus. Corp. Act Ann. section 1.29.

n83 Id.

n84 See note 81.

n85 *Hall v. John S. Isaacs & Sons Farms, Inc., 146 A.2d 602, 609-10 (Del. Chanc. 1958).* Hall refers to former section 144, and states the general principle that directors must honestly disclose all material facts when they undertake to disclose corporate information, but finds no proof of "false or fraudulent annual reports," and rejects such as a basis for appointment of a receiver. *Id. at 610.* Thus, Hall is incorrectly cited as a case under former section 144 "imposing liability for false disclosure." Brown, Corporate Disclosure section 9.02 at 9-4 (cited in note 22). To the contrary, Hall's reference to former section 144 and a duty of disclosure on the part of corporate directors is dictum.

Likewise, the case relied on in Marhart to establish that the disclosure duty described in Hall persisted after repeal of former section 144--Kelly v. Bell--even less persuasive in supporting the existence of a fiduciary duty of disclosure to stockholders. True, Kelly does state, citing Hall, that "directors owe a duty to honestly disclose all material facts when they undertake to give out statements about the business to stockholders." *Kelly, 254 A.2d at 71.* The claim before the court, however, was that the directors should be liable in a derivative suit for payments made to local governments. The legal issue was whether the protection of the business judgment rule should be denied because the directors' description of those payments as "taxes" "constituted fraud or gross abuse of discretion." Id. The statement in Kelly on which the court in Marhart relied is, like the comparable statement in Hall, pure dictum.

n86 See Pease, *14 Del. J. Corp. L. at 448* (cited in note 22) ("As early as 1946, the court of chancery discussed disclosure requirements in *Empire Southern Gas Co. v. Gray, [46 A.2d 741 (1946)]*.").

n87 *Willoughby v. Port, 182 F. Supp. 496, 499 (S.D.N.Y. 1960),* modified on other grounds, *277 F.2d 149 (2d Cir. 1960)* (enjoining dissident stockholders from exercising proxies, and holding that "those who seek the proxies of their fellow corporate shareholders assume a fiduciary obligation"); *Dal-Tran Service Co. v. Fifth Ave. Coach Lines, Inc., 220 N.Y.S.2d 549, 554 (N.Y. App. Div. 1961)* (following Willoughby but sustaining uncontested election of management nominees); *Skora v. Great Sweet Grass Oils, Ltd., 205 N.Y.S.2d 98, 104-06 (N.Y. Sup. Ct. 1960)* (finding that while proxies solicited by dissident stockholders of an Ontario corporation were "invalid under the law of Ontario" because they "were obtained by reason of fraudulent representations or fraudulent omissions of material facts . . . . Even if the publicity here was defective only in that it did not tell the whole truth, the failure to make such a full disclosure would have been a breach of fiduciary obligation").

n88 In addition to the cases cited in note 87, see *Bresnick v. Home Title Guaranty Co., 175 F. Supp. 723 (S.D.N.Y. 1959); Empire Southern Gas Co. v. Gray, 46 A.2d 741 (Del. Chanc. 1946); Goldfield Corp. v. General Host Corp., 327 N.Y.S.2d 330, 277 N.E.2d 387 (N.Y. 1971); Mason v. Basic Properties, Inc., 230 N.Y.S.2d 560 (N.Y. Sup. Ct. 1962),* aff'd, *232 N.Y.S.2d 391, 17 A.D.2d 769 (N.Y. App. Div. 1962); In re R. Hoe & Co., 137 N.Y.S.2d 142 (N.Y. Sup. Ct. 1954),* aff'd, *139 N.Y.S.2d 883 (Sup. Ct. App. Div. 1955),* aff'd, *309 N.Y. 719, 128 N.E.2d 420 (1955); Wyatt v. Armstrong, 59 N.Y.S.2d 502 (N.Y. Sup. Ct. 1945); In re Scheuer, 59 N.Y.S.*

2d 500 (N.Y. Sup. Ct. 1942); Continental Bank & Trust Co. of New York v. 200 Madison Avenue Corp., 43 N.Y.S.2d 402 (N.Y. Sup. Ct. 1943); Western Oil Fields, Inc. v. McKnab, 232 F. Supp. 162 (D. Colo. 1964). See also Comment, Standards of Disclosure in Proxy Solicitation of Unlisted Securities, *1960 Duke L. J. 623, 637* (apparently chafing at the then inapplicability of federal proxy rules to unlisted companies, urging that "the state courts should insure protection to the stockholder through the establishment of minimum standards of disclosure or, in the alternative, consider the proxy rules of the Securities and Exchange Commission when passing upon the adequacy of disclosure in solicitation"); Edward Ross Aranow and Herbert A. Einhorn, State Court Review of Corporate Elections, *56 Colum. L. Rev. 155, 160-61, 176 (1956)* (discussing state cases involving challenges to proxy solicitation); John E. Theuman, Annotation, Misrepresentation in Proxy Solicitation--State Cases, *20 A.L.R.4th 1287 (1983)* (listing cases).

n89 Securities Acts Amendments of 1964, Pub. L. No. 88-467, sections 3(c), 5(a), 78 Stat. 565, 566-67, 569 (1964). Since 1964, cases invoking only state common law disclosure duty on the part of proxy solicitors have become a rarity. A rare exception--a case involving a Native American development corporation exempted by federal statute from the reach of the securities laws--indicates that such state law cases have been displaced by litigation under section 14(a) of the Exchange Act, and Rule 14a-9 promulgated pursuant to that statute. *Brown v. Ward, 593 P.2d 247 (Alaska 1979).* Indeed, the Brown case, even while nominally applying state law, simply followed standards under the federal securities laws as "a useful guide in determining when a misstatement is material under Alaska common law." *Id. at 250.* The dissent in that case, however, cogently disagreed:

Certainly there is no reason, in law or policy, why Alaska must march in lockstep with the federal government on this subject . . . . [Courts applying common law proxy solicitation disclosure duties] have taken a compromise position between the federal standard and the common law tort of misrepresentation.

Id. at 255 (O'Connor, J. dissenting). See also *Washington State Labor Council v. Federated American Ins. Co., 474 P.2d 98, 101 (Wash. 1970)* (holding that a state statute governing solicitation of proxies of stock of insurers and requiring disclosure of "the material matters in regard to which the powers so solicited are proposed to be used," did not require advance disclosure by management of its strategy for cumulating votes at the meeting).

n90 Although the cases sometimes characterize the proxy solicitor's disclosure duty as arising from a fiduciary relationship with the solicitees, see note 87 and accompanying text, the cases more commonly invoke principles of common law fraud, a doctrine applicable without regard to any preexisting fiduciary relationship, and therefore applicable not only to traditional corporate fiduciaries but to dissident proxy solicitors as well. See, for example, *Bresnick, 175 F. Supp. at 725* ("The test is not compliance with the technical rules, but rather whether the proxy soliciting material was so tainted with fraud that an inequitable result was accomplished."); *Empire Southern Gas Co., 46 A.2d at 743* ("Both precedent and practice support the right of this court to interfere prior to a stockholders' meeting to prevent fraud in the solicitation of proxies."); *Continental Bank, 43 N.Y.S.2d at 405* ("The proof failed to establish any fraud in the securing [by dissident voting trust certificate holders] of proxies, either by way of untruthful statements of material facts or the suppression of material facts such as would amount to fraud . . . . This court should limit its consideration solely to the question of whether there was fraud in soliciting the proxies."); *Western Oil Fields, 232 F. Supp. at 164* ("Apparently a stronger showing of fraud must be made when an injunction is sought under state law than when it is sought for a violation of SEC Proxy Rule X-14A-9 forbidding false or misleading statements.") (citing Edward Ross Aranow and Herbert A. Einhorn, Proxy Contests For Corporate Control 435 (Columbia U., 1957)).

The fraud basis of the state proxy solicitation cases is consistent with the insistence in some of those cases that a stockholder vote will be set aside only if the challenger can demonstrate actual reliance by stockholders upon the allegedly defective disclosure, or that the result of the vote would have been different but for the defective disclosure. *Goldfield, 277 N.E.2d at 392* ("The test . . . is whether . . . there is a substantial likelihood that the misstatement . . . may have led a stockholder to grant a proxy to the solicitor or to withhold it . . . whereas in the absence of this he would have taken a contrary course.") (quoting *General Time Corp. v. Talley Industries, 403 F.2d 159, 162 (2d Cir. 1968)); Bresnick, 175 F. Supp. at 725* (holding that facts allegedly omitted from the management proxy statement were "fully disclosed in letters sent to stockholders by the committee opposing the plan and there is no indication in the papers that the stockholders were misled by omission to put these particular figures in the Management proxy soliciting material"); *Continental Bank, 43*

N.Y.S.2d at 408 ("None of the statements of facts which are alleged to be untrue would, in the opinion of the court, influence any layman to give a proxy where he would not otherwise have done so."); *R. Hoe & Co., 137 N.Y.S.2d at 148* ("Even assuming there were misstatements or concealments, the election may not be set aside unless the court concludes further that the result would have been different had no such improprieties been injected into the proxy campaign, or that an inequitable result has been thereby produced."); *Mason, 230 N.Y.S.2d at 563* ("I do not find that the alleged misstatements and concealments in the Proxy Statement were such as to mislead a substantial number of stockholders as to alter the probable result of the vote on the adoption of the plan."). Compare *Scheuer, 59 N.Y.S.2d at 501* ("It is not necessary to show that stockholders were actually deceived. It is sufficient to show that they might have been.") (citing *American Hide, 127 A. at 661).* The more relaxed reliance and causation tests recited without analysis in Scheuer are probably attributable to the context of the American Hide case on which Scheuer relied. The challenge to the stockholder vote in American Hide arose not in a contested election, but because defendants had invoked stockholder ratification in defense of a self-dealing contract between a director and the corporation--a context in which fiduciary disclosure duties have traditionally been applied. *American Hide, 127 A. at 660.* See Part III.A.

n91 *Western Oil Fields, 232 F. Supp. at 166; Willoughby, 182 F. Supp. at 499; Empire Southern Gas Co., 46 A.2d at 746; Skora, 205 N.Y.S.2d at 104; R. Hoe & Co., 137 N.Y.S.2d at 147-48; Wyatt, 59 N.Y.S.2d at 506; Continental Bank & Trust, 43 N.Y.S.2d at 406-07.*

n92 See *Hauth v. Giant Portland Cement Co., 96 A.2d 233, 235 (Del. Chanc. 1953)* ("The person designated in a proxy has a fiduciary obligation to carry out the wishes of the stockholders to the best of his ability."); *Abbey Properties Co. v. Presidential Insurance Co., 119 So.2d 74, 78 (Fla. Dist. Ct. App. 1960)* (holding that the proxy relationship is one of agent and principal); Fletcher, 5 Cyclopedia of the Law of Private Corporations section 2060 at 291 (cited in note 61) ("The person to whom the proxy runs is the shareholder's agent, and must vote in accordance with the instructions given him or her, either openly or tacitly, by the latter, and as a fiduciary.").

State v. Jefferson Lake Sulphur Co., 36 N.J. 577, 178 A.2d 329 (1962), illustrates the wide scope of the courts' willingness to employ fiduciary doctrine to sustain a disclosure obligation. The court held that management, as custodian of unclaimed dividend funds attributable to lost stockholders, had a fiduciary duty to disclose all material facts when seeking the approval of stockholders (presumably those stockholders who were not lost) for a charter amendment cutting off rights to dividends unclaimed for a defined time period, in order to avoid escheat. Id. at 332-34. The court stated:

Even assuming that the charter change under review was not ultra vires, in a situation where a corporation seeks to influence its stockholders to 'escheat' their property to it rather than have it pass to the State, the fiduciary status which the corporation occupies with respect to the unclaimed dividends calls for full and fair disclosure of all the relevant facts upon which the stockholders' decision should be formulated. Obviously the obligation was not adequately discharged by the proxy statement and that reason alone is sufficient warrant for invalidating the amendment.

Id. at 333. As discussed in Part V.C below, the rationale for this decision could have been better articulated as a duty to disclose all material facts to stockholders to whom a recommendation is being made, rather than as a duty to an unclaimed pot of cash, or to those who have claims to that cash but who were not even aware of, let alone voting upon, the proposed charter provision.

n93 See Part V.C.

n94 Brown thus notes that the Empire Southern Gas Co. v. Gray case, in which proxies were challenged because certain officers misleadingly claimed endorsement by the Board, was not "a true duty of candor case." Brown, Corporate Disclosure section 9.02 at 9-4 n.8 (cited in note 22). Similarly, Solomon discusses the state law cases governing proxy solicitation entirely separately from the analysis of the "Delaware duty of disclosure." Solomon, Corporations Law at 841-43, 890-96 (cited in note 30).

n95 See, for example, *Wolf, 477 F.2d at 477; Gaynor v. Buckley, 318 F.2d 432, 435 (9th Cir. 1963); Ramacciotti v. Joe Simpkins, Inc., 427 S.W.2d 425, 432 (Mo. 1968); Barclay v. Dublin Lake Club, 89 N.H. 500, 1 A.2d 633, 636 (1938); Iback v. Elevator Supplies Co., Inc., 177 A. 458, 459 (N.J. Chanc. 1935).* See also Fletcher, 2A Cyclopedia of the Law of Corporations section 764 at 549 (perm. ed. 1992) (cited in note 61) ("Shareholders must have knowledge before they will be deemed to have barred their rights by ratification.").

n96 *114 A. 224 (Del. Chanc. 1921)*, aff'd, *118 A. 1 (Del. 1922).*

n97 *Id. at 234.*

n98 *Michelson v. Duncan, 407 A.2d 211, 219-20 (Del. 1979); Hannigan v. Italo Petroleum Corp., 47 A.2d 169, 172 (Del. 1945); Peters v. Waverly Water-Front Improvement & Development Co., 113 Va. 318, 74 S.E. 168, 170 (1912).* See also Henry Winthrop Ballantine, Ballantine on Corporations section 60 at 151-52 (Callaghan, rev. ed. 1946).

n99 *Gottlieb v. Heyden Chemical Corp., 91 A.2d 57, 58-59 (Del. 1952); Fidanque v. American Maracaibo Co., 92 A.2d 311, 321 (Del. Chanc. 1952).* The entire fairness doctrine is a device by which the courts impose upon self-dealing corporate directors the burden of establishing that their transactions with the corporation are fair both substantively, that is, as to price, and procedurally. See, for example., *Weinberger, 457 A.2d at 710-11;* Block, Barton, and Radin, Business Judgment Rule at 131-32 (cited in note 30); Lawrence A. Mitchell, Fairness and Trust in Corporate Law, *43 Duke L. J. 425, 443-45 (1993);* ALI Principles section 5.02(b) (cited in note 32). The Delaware Supreme Court has said that the entire fairness test requires "careful scrutiny" by the courts, *Weinberger, 457 A.2d at 710*, and that determining whether to apply that test "frequently is determinative of the outcome" of litigation challenging a self-dealing transaction. *Nixon v. Blackwell, 626 A.2d 1366, 1376 (Del. 1993)* (citing *Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1988)).* In recent years, however, the Delaware Supreme Court has upheld several transactions despite applying that ostensibly demanding test. *Kahn, 669 A.2d at 79; Cinerama, 663 A.2d at 1156; Nixon, 626 A.2d at 1366.*

n100 Stockholder ratification, in traditional form, has been described as "the voluntary addition of an independent layer of shareholder approval in circumstances where such approval is not legally required." *In re Wheelabrator Technologies, Inc. Shareholders Litigation, 663 A.2d 1194, 1202 n.4 (Del. Chanc. 1995).* The term "stockholder ratification" thus does not, at least in classic form, describe stockholder approval of actions, such as a merger, that by statute cannot occur without stockholder approval. *Id. Compare Geier, 671 A.2d at 1379 n.24* (distinguishing actions which by statute must be approved by stockholders from actions for which stockholder approval is sought but not required by statute).

n101 Where directors approve a merger agreement without the requisite care, stockholder approval of the transaction has been held to extinguish the claim of breach of the fiduciary duty of care. See *Santa Fe, 669 A.2d at 67; Wheelabrator, 663 A.2d at 1203; Van Gorkom, 488 A.2d at 889.* Even where director action implicates the duty of loyalty due to conflicts of interest, stockholder approval of the transaction at issue, even where required by statute, has been held "either to change the standard of review to the business judgment rule, with the burden of proof resting upon the plaintiff, or to leave 'entire fairness' as the review standard, but shift the burden of proof to the plaintiff." *Wheelabrator, 663 A.2d at 1203; Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 501 (Del. Chanc. 1990); Van Gorkom, 488 A.2d at 890; Weinberger, 457 A.2d at 703.*

n102 *Van Gorkom, 488 A.2d at 893; Weinberger, 457 A.2d at 703; Gerlach v. Gillam, 139 A.2d 591, 595 (Del. Chanc. 1958).*

n103 *Gerlach*, *139 A.2d at 593* ("I have no doubt concerning Mr. Gillam's [the "Comptroller," or dominant manager's] obligation to exhibit complete candor in dealings involving a conflict between his personal interests and those of United's stockholders."). Pease correctly identified Gerlach as the source of the "complete candor" terminology. *14 Del. J. Corp. L. at 449* (cited in note 22).

n104 The stockholder approval was quite narrow: of the 520,200 shares outstanding, fewer than half (246,609 shares) were voted in favor of the challenged agreements, and 204,670 shares were voted against. *Gerlach*, *139 A.2d at 592.*

n105 Id.

n106 *Id. at 593* ("Where a majority of fully informed stockholders ratify action of even interested directors, an attack on the ratified transaction normally must fail.").

n107 Id.

n108 See, for example, Scott and Fratcher, 2A Law of Trusts section 170.1 at 317-18 (cited in note 49); George Gleason Bogert and George Taylor Bogert, The Law of Trusts and Trustees section 941 at 389 (Vernon Law Books, 2d ed. 1960). See Part V.B.

n109 *Michelson v. Duncan, 386 A.2d 1144, 1154 (Del. Chanc. 1978)*, aff'd in part and rev'd in part, *407 A.2d 211 (Del. 1979).*

n110 *Id. at 1154-55.*

n111 See also *Schreiber v. Pennzoil Co., 419 A.2d 952, 957 (Del. Chanc. 1980)* (noting that stockholder ratification of an allegedly wasteful transaction shifts to plaintiff the burden of persuasion, and relieves defendants of the "heavy burden of proving the intrinsic fairness of the transaction." The court explained further that in evaluating the efficacy of stockholder ratification, "the only remaining question on the allocation of the burden of persuasion . . . is whether the stockholders were fully informed with complete candor of all the germane facts surrounding the disputed transaction." (citing *Lynch, 383 A.2d at 278)).*

n112 See Part IV.

n113 *Arnold, 650 A.2d at 1276.*

n114 Brown, Corporate Disclosure section 9.02 at 9-4 (cited in note 22).

n115 Solomon, Corporations Law at 890 (cited in note 30).

n116 Oesterle and Palmiter, *79 Iowa L. Rev. at 565* (cited in note 30).

n117 In one case, a corporation resisting a hostile tender offer argued that Lynch imposed upon the bidder "the duty of full and candid disclosure required of corporate management under Delaware law." Servomation Corp. v. City Investing Co., *4 Del. J. Corp. L. 599, 604 (Del. Chanc. 1979).* The court's rejection of that argument reflected a particularly thoughtful recognition of Lynch as evolutionary, not revolutionary, legal doctrine:

[While Lynch was] a decision which spoke to the duty of candor imposed on an offeror in a tender offer context, I feel it significant to note that there the offeror was a majority shareholder tendering for shares in its subsidiary corporation. There are unquestionably fiduciary duties imposed on a parent in dealing with the minority shareholders of its subsidiary as our cases have held for years. However, the decision there was premised on the fiduciary duties deriving from that relationship and not upon the requirements of the tender offer statute. That rationale does not fit here since [the bidder] has no such relationship with [the target].

Id. at 605.

n118 Norman D. Lattin, The Law Of Corporations section 81 at 295 (Foundation Press, 2d ed. 1971). See also William L. Cary and Melvin Aron Eisenberg, Cases and Materials on Corporations 814-16 (Foundation Press, 7th ed. 1995); Robert W. Hamilton, Cases and Materials on Corporations Including Partnerships and Limited Partnerships 900-02 (West, 5th ed. 1994); R. E. Heinselman, Annotation, Duty of Officer or Director of Corporation Toward One From Whom He Purchases Stock, *84 A.L.R. 615 (1933).*

n119 See, for example, *Van Schaack Holdings, Ltd. v. Van Schaack, 867 P.2d 892, 898 (Colo. 1994)* (holding that directors, especially in closed corporations, have a duty of disclosure in order to "provide some degree of equalization of bargaining position . . ."); *Bailey v. Vaughan, 359 S.E.2d 599, 604 (W. Va. 1987)* ("It must be shown that he [the director] possessed some special knowledge not available to the shareholder which enabled him to purchase the stock at a price that was lower than its actual value."); *Weinberger, 457 A.2d at 711* ("One possessing superior knowledge may not mislead any stockholder by use of corporate information to which the latter is not privy.").

n120 See Fletcher, 3A Cyclopedia of the Law of Private Corporations section 1168.10 at 397 (cited in note 61).

n121 Id. section 1168.20 at 404.

n122 Id. section 1171 at 409.

n123 See, for example, *Van Schaack, 867 P.2d at 896-97* (listing special circumstances that could give rise to a duty to disclose).

n124 See *Bailey, 359 S.E.2d at 603-605* (questioning the clarity of the traditional division of authority, and holding that "a director, who solicits a shareholder to purchase his stock and fails to disclose information not known to the shareholder that bears upon the potential increase in value of the shares, shall be liable to the shareholder either to have the sale rescinded or to respond in damages"). See generally Joel Seligman, The Reformulation of Federal Securities Law Concerning Nonpublic Information*, 73 Geo. L. J. 1083, 1093-1102 (1985);* Sherwood E. Sterling, Note, "Wherefore Art Thou, Fiduciary?": The Securities and Exchange Act of 1934 and the Common Law Fiduciary Duty of the Director, *35 U. Colo. L. Rev. 410 (1963);* A.A. Berle, Jr., Publicity of Accounts and Directors' Purchases of Stock, *25 Mich. L. Rev. 827, 833-34 (1927)* (discussing the the origins of the "special circumstances" rule of fiduciary duty requiring disclosure by director/officer of material facts when a fiduciary relation with the buyer/seller exists).

n125 Sterling, *35 U. Colo. L. Rev. at 417* (cited in note 124) (citing Kors v. Carey, 39 Del. Chanc. 47, *158 A.2d 136, 143 (1960)*, for the proposition that "Delaware follows the majority rule"). See also Lank v. Steiner, 43 Del. Chanc. 262, *224 A.2d 242, 244 (1966)* (noting that the "special circumstances rule applies only when a director is possessed of special knowledge of future plans or secret resources and deliberately misleads a stockholder who is ignorant of them," and expressly approving the ruling in Kors).

n126 39 Del. Chanc. 47, *158 A.2d 136 (1960).*

n127 In the two years following the repurchase, the aggregate market value of the stock in question increased from $ 1,685,600 to over $ 2,700,000. Kors v. United Whelan Corp., Fed. Secur. L. Rptr. (CCH) paragraph 90,970 (S.D.N.Y. June 7, 1960). In contrast, United Whelan's profit on the repurchase was only $ 50,000. Id. Adding insult to injury, United Whelan, after failing in its effort to undo the repurchase in the Delaware Court of Chancery litigation, was forced to pay almost $ 10,000 of its profits back to the issuer in settlement of a short-swing trading claim under section 16(b) of the Securities Exchange Act of 1934, *15 U.S.C. section 78p*(b). Id.

n128 As explained by the Delaware Supreme Court, "the term 'greenmail' refers to the practice of buying out a takeover bidder's stock at a premium that is not available to other shareholders in order to prevent the takeover." *Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 956 n.13 (Del. 1985).*

n129 *Kors, 158 A.2d at 142.*

n130 As the court explains:

It is only in special cases where advantage is taken of inside information and the like that the selling stockholder is afforded relief and then on the basis of fraud . . . . This case is clearly not one in which a buyer possessed with special knowledge of future plans or of secret and untapped resources deliberately misleads an ignorant stockholder . . . .

Id. at 143 (citations omitted).

Of course, the repurchase at issue in Kors did not involve acquisition of stock by the directors individually. Had the directors been purchasing stock for their own account and personally benefiting from the use of inside information, the court might well have drawn an analogy to Brophy v. Cities Service Co., 31 Del. Chanc. 241, *70 A.2d 5 (1949)*, a case not cited in Kors. Brophy held that a fiduciary such as a director or officer must account to the corporation for all profits derived from use of "secret" information learned through his position as a fiduciary. *Id. at 7-8.* It would not have been an implausible leap to extend that duty to a case where the fiduciary's profit from "secret" information comes at the expense of an outside stockholder from whom he acquires stock. See Sterling, *35 U. Colo. L. Rev. at 417* (cited in note 124).

n131 *Kors, 158 A.2d at 143.*

n132 The rationale for protecting informationally disadvantaged stockholders is noted at note 119. A similar unwillingness to apply fiduciary disclosure duties in favor of a sophisticated institutional investor negotiating directly with management is reflected in Trustees of General Electric Pension Trust v. Levenson, 1992 Del. Chanc. LEXIS 43, *10-11 (Mar. 3, 1992) (dismissing a "duty of candor" claim absent "special circumstances that would state a claim for willful concealment under Kors").

n133 *Kors, 158 A.2d at 143.*

n134 *224 A.2d 242 (Del. 1966).*

n135 The transaction granted of an option to acquire the stock at book value, then $ 270 per share, after his death. *Id. at 244.*

n136 *Id. at 245.* Justice Daniel L. Herrmann dissented vigorously, urging his colleagues to reject this finding and determine that the purchaser's greater business experience and close personal relationship with the grantor of the option gave rise to "a relation of trust and confidence" and "a fiduciary relation . . . such as gives rise to a presumption of the invalidity of the stock options." *Id. at 247* (Herrmenn, J., dissenting).

n137 See, for example, *Bryan v. Brock & Blevins Co., 490 F.2d 563 (5th Cir. 1974); Albright v. Bergendahl, 391 F. Supp. 754 (D. Utah 1974);* Jutkowitz v. Bourns, No. CA00028, slip op. (Cal. App. Dept. Super. Ct. Nov. 19, 1975); *Berkowitz v. Power/Mate Corp., 135 N.J. Super. 36, 342 A.2d 566 (1975).*

n138 *Mansfield Hardwood Lumber Co. v. Johnson, 268 F.2d 317, 320-22 (5th Cir. 1959)* (remarking that "apparently Delaware imposes no fiduciary duty on the part of officers or directors or majority stockholders in buying stock from the minority or individual stockholders," and characterizing such a rule as "inequitable"). See also William L. Cary, Federalism and Corporate Law: Reflections Upon Delaware, *83 Yale L. J. 663, 672-73 (1974);* Arthur M. Borden, Going Private--Old Tort, New Tort or No Tort?, *49 N.Y.U. L. Rev. 987 (1974).*

n139 See 306 A.2d at V nn.2b, 2c.

n140 *Lynch, 383 A.2d at 281.*

n141 As Chancellor Marvel explains:

In situations in which the holder of a majority of the voting shares of a corporation, as here, seeks to impose its will upon minority stockholders, the conduct of such majority must be tested by those same standards of fiduciary duty which directors must observe in their relations with all their stockholders, ... The majority stockholder here, namely Vickers, had a duty to exercise complete candor in its approach to the minority stockholders of TransOcean for a tender of their shares, namely a duty to make a full disclosure of all of the facts and circumstances surrounding the offer for tenders, including the consequence of acceptance and that of refusal . . . .

Lynch, 351 A.2d at 573.

n142 To be sure, the court's citation of Lank as "applying the 'special circumstance rule,' " see *Lynch, 383 A.2d at 279,* seems revisionistic since Lank limited that rule to cases of deliberate deception. *Lank, 224 A.2d at 244.*

n143 *Lynch, 383 A.2d at 279.*

n144 *Mansfield Hardwood Lumber Co., 268 F.2d at 319; Agatucci v. Corradi, 327 Ill. App. 153, 63 N.E.2d 630, 632 (1945); Jacobson v. Yaschik, 249 S.C. 577, 155 S.E.2d 601, 606 (1967); Shermer v. Baker, 472 P.2d*

589, 593-94 (Wash. App. 1970). But see Trustees of General Electric Pension Trust, 1992 Del. Chanc. LEXIS 43 at *11 (applying Kors's requirement of "willful concealment" to a claim that management failed to disclose an allegedly planned restructuring during arm's length settlement negotiations with a sophisticated institutional investor).

n145 See Part III.A.

n146 *457 A.2d 701 (Del. 1983).* See also Fisher v. United Technologies Corp., *6 Del. J. Corp. L. 380 (Del. Chanc. 1981),* a case which invoked Lynch but, finding the proxy statement disclosures adequate, granted summary judgment against a minority stockholder challenging a cash out merger by an acquiror which was a 49% "controlling stockholder," at the time of the merger. The merger was structured to require approval of a majority of the public minority stockholders. *Id. at 383.*

n147 The architects of the merger attempted to strengthen the force of this "majority of the minority" vote requirement by insisting that two-thirds of the outstanding shares (including the 50.5% stockholder's shares), rather than the bare majority required by statute, be voted in favor of the merger. *Weinberger, 457 A.2d at 707.* Thus, approval by at least 32% of the outstanding minority shares was a precondition to effectiveness of the merger.

n148 *Id. at 703* ("Where corporate action has been approved by an informed vote of a majority of the minority shareholders, we conclude that the burden entirely shifts to the plaintiff to show that the transaction was unfair to the minority.").

n149 *Id. at 711* (citing *Lank, 224 A.2d at 244).* The fact that Weinberger followed Lynch in misreading Lank to have established the broad proposition that "one possessing superior knowledge may not mislead any stockholder by use of corporate information to which the latter is not privy" illustrates the influential force of the Lynch opinion. See text accompanying note 147.

n150 *Weinberger, 457 A.2d at 712* (citing Cahall v. Lofland, 12 Del. Chanc. 299, *114 A. 224 (Del. Chanc. 1921)).*

n151 See Part V.B.

n152 *488 A.2d 858 (Del. 1985).* In fairness, one should observe that the Delaware Court of Chancery, even before Smith v. Van Gorkom, carried the broad "duty of candor" language of Lynch into uncharted legal territory. While most of the pre-Van Gorkom court of chancery cases can be viewed as stock purchase/freeze-out cases (like Lynch) or ratification cases (like Gerlach and Michelson), four court of chancery opinions invoke the Lynch duty of candor language to evaluate proxy disclosures in other contexts. *Thompson v. Enstar Corp., 509 A.2d 578, 584 (Del. Chanc. 1984)* (denying a preliminary injunction against a proposed merger, but reciting a (satisfied) "requirement of a full and complete disclosure, with complete candor, of all the material information which is needed by a shareholder of Enstar to make an informed decision"); Cavalcade Oil Corp. v. Texas American Energy Corp., *9 Del. J. Corp. L. 417, 418-19 (Del. Chanc. 1984)* (enjoining implementation of charter amendment providing for a staggered board, where proxy statement incorrectly, but inadvertently, exaggerated stockholders' ability to undo the amendment later); Weinberger v. United Financial Corp. of California, C.A. No. 5915, slip op. (Del. Chanc. Oct. 13, 1983) (addressing claims that the proxy statement was false and misleading due to misstatements and omissions of material fact); American Pacific Corp. v. Super Food Services, Inc., *8 Del. J. Corp. L. 320, 325-26 (Del. Chanc. 1983)* (relying on stockholder confusion concerning the nature and vote required for adoption of certain defensive charter provisions as a basis for a finding of irreparable injury justifying a preliminary injunction). See also *Edelman v. Salomon, 559 F. Supp. 1178, 1184-85 (D. Del. 1983)* (invoking Lynch as a grounds for nullifying a charter amendment eliminating cumulative voting, based on material omissions in the proxy statement). As discussed below in Part V.C, the three cases in which a preliminary injunction was granted, Cavalcade and American Pacific, or sought, Enstar, fit logically into the analytical framework suggested in this Article, as does the Edelman case involving rescission.

n153 *Van Gorkom, 488 A.2d at 874-84.* The comments elicited by this aspect of the opinion were formidable in volume and tone. See, for example, Daniel R. Fischel, The Business Judgment Rule and the Trans Union Case, *40 Bus. Law. 1437, 1455 (1985)* (stating that Van Gorkom was "surely one of the worst decisions in the history of corporate law"); William T. Quillen, Trans Union, Business Judgment, and Neutral Principles, *10 Del. J. Corp. L. 465, 470 (1985)* (arguing that the Trans Union opinion "is burdened by overkill and by needless, and often erroneous, legal and factual excess"); Arthur M. Borden, First Thoughts on Decision in Delaware on Trans Union, N.Y. L. J. 1 (Feb. 25, 1985); Bayless Manning, Reflections and Practical Tips on Life in the Boardroom After Van Gorkom, *41 Bus. Law. 1, 1 (1985)* (noting that commentators viewed the decision as "atrocious"); Leo Herzel and Leo Katz, Smith v. Van Gorkom: The Business of Judging Business Judgment, *41 Bus. Law. 1187, 1189 (1986)* (arguing that Van Gorkom "rests on widespread fallacy").

Even several years after it was decided, Van Gorkom prompted scholars to reexamine the case to divine some rationale more satisfactory than the "ill-fitting" duty of care theory invoked by the court. Alan R. Palmiter, Reshaping the Corporate Fiduciary Model: A Director's Duty of Independence, *67 Tex. L. Rev. 1351, 1354-55 (1989)* (suggesting a director "duty of independence" as a superior rationale); Jonathan R. Macey and Geoffrey P. Miller, Trans Union Reconsidered, *98 Yale L. J. 127, 128 (1988)* (viewing Van Gorkom as a takeover case enhancing director authority to resist hostile tender offers).

n154 *Van Gorkom, 488 A.2d at 889-93.*

n155 Part III.A.

n156 As the court notes:

The parties tacitly agree that a discovered failure of the Board to reach an informed business judgment in approving the merger constitutes a voidable, rather than a void, act. Hence, the merger can be sustained, notwithstanding the infirmity of the Board's action, if its approval by majority vote of the shareholders is found to have been based on an informed electorate.

Van Gorkam, 488 A.2d at 889. In more recent challenges to mergers, the courts and the litigants accepted this conclusion, agreeing that "if the . . . shareholder vote was fully informed, the effect of that informed vote would be to extinguish the claim that the . . . board failed to exercise due care in negotiating and approving the merger." *Wheelabrator, 663 A.2d at 1200.* See also *Santa Fe, 669 A.2d at 67.*

n157 *Van Gorkam, 488 A.2d at 889-90* (citing *Michelson, 407 A.2d at 211, Gerlach, 139 A.2d at 591,* and *Schreiber, 419 A.2d at 591,* as well as *Gottlieb v. Heyden Chemical Corp., 91 A.2d 59 (Del. 1952),* all conventional ratification cases).

n158 *Van Gorkom, 488 A.2d at 893.*

n159 Id.

n160 Id.

n161 *663 A.2d 1156 (Del. 1995).*

n162 *Id. at 1166.*

n163 *488 A.2d at 889-93* (citing Lynch, Weinberger, Michelson, Schreiber, Gerlach, and Gottlieb).

n164 Indeed, as developed below, this Article argues that such a duty does exist. See Part V.C.

n165 The history of the Delaware cases enunciating a fiduciary "duty of candor" or duty of disclosure is replete with broad statements of the duty followed by findings that the duty was not violated, or could not in any event result in director liability. See, for example, *Kahn v. Roberts, 1996 Del. LEXIS 275,* *1 (July 25, 1996); *Williams v. Geier, 671 A.2d at 1379; Santa Fe, 669 A.2d at 66-67; Kahn, 669 A.2d at 88-89; Cinerama, 663 A.2d at 1176; Arnold, 650 A.2d at 1270; Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 372 (Del. 1993); Stroud, 606 A.2d at 88; Rosenblatt, 493 A.2d at 945; Michelson, 407 A.2d at 222;* Loudon v. Archer-Daniels-Midland Co., 1996 Del. Chanc. LEXIS 12, *1 (Feb. 20, 1996); Emerald Partners v. Berlin, 1995 Del. Chanc. LEXIS 128 at *1 (Sep. 22, 1995); Zirn v. VLI Corp., 1995 Del. Chanc. LEXIS 74, *1 (June 12, 1995), aff'd, *1996 Del. LEXIS 320* (Del. Aug. 23, 1996); Lewis v. Leaseway Transportation Co., 1990 Fed. Secur. L. Rep. (CCH) paragraph 96,268; *In re J.P. Stevens & Co., Inc. Shareholders Litigation, 542 A.2d 770, 784 (Del. Chanc. 1988); Schreiber, 419 A.2d at 957-58.*

n166 See, for example, *In re Anderson, Clayton, 519 A.2d at 689-90* (applying Van Gorkom standard to enjoin merger with subsidiary of employer stock ownership plan).

n167 *517 A.2d 271 (Del. Chanc. 1986).*

n168 *Id. at 276.*

n169 As the Lacos Land court explains

It is, of course, well established in our law that an element of the fiduciary duty that directors owe to shareholders is the duty, arising when the board is required or elects to seek shareholder action, to disclose fully and fairly pertinent information within the board's control.

Id. at 279.

n170 The omitted fact was a significant but quite technical elaboration of whether the CEO/21% stockholder would be a "Restricted Person" for purposes of a business combination supermajority vote requirement in the certificate of incorporation. *Id. at 279-81.*

n171 *Id. at 279.*

n172 *519 A.2d 116 (Del. Chanc. 1986).*

n173 *Id. at 119.*

n174 *Id. at 121* (stating that it is "the now well-settled rule of Delaware law that corporate directors owe the corporation's stockholders a fiduciary duty to disclose all facts germane to a transaction involving stockholder action, in an atmosphere of complete candor"). See also Zirn v. VLI Corp., *18 Del. J. Corp. L. 803, 813-14 (Del. Chanc. 1992)*, rev'd on other grounds, *621 A.2d 773 (Del. 1993)* (holding that proof of a mischaracterization in a Schedule 14D-9 of the disinterested directors' reason for approving a revised merger agreement "might have established a breach of the . . . directors' fiduciary duty of disclosure").

Despite the broad language in Rio Grande mandating that directors assure that all facts material to pending stockholder action be disclosed, directors have not been found obliged to correct the misstatements or omissions of a third party tender offeror. See *Citron v. Fairchild Camera and Instrument Corp., 569 A.2d 53, 70 (Del. 1989);* Solash v. Telex Corp., 1987-1988 Fed. Secur. L. Rptr. (CCH) paragraph 93,608 at 97,729 (Del. Chanc. Jan. 19, 1988).

n175 The only authorities the court did cite in this regard were Lynch, which the court viewed as "the appropriate analytic starting point" for any "claim of material nondisclosure," Van Gorkom, and Rosenblatt, a case addressing a cash-out merger with a majority stockholder and, thus, analytically parallel to *Weinberger. Rio Grande, 519 A.2d at 121.*

n176 See note 66. To be sure, one could argue that the directors in Rio Grande were directly involved in presenting the tender offer to the stockholders because that offer proceeded pursuant to a merger agreement which the directors had approved. There is nothing in the Rio Grande opinion, however, to limit the fiduciary disclosure duty to this context, or to suggest that such a duty would not apply equally to a Schedule 14D-9 filed in relation to a tender offer not agreed to in advance by the directors.

n177 Marhart, *18 Del. J. Corp. L. at 330.* Marhart was a class action seeking damages based on a press release misleadingly exaggerating the benefits of a proposed defensive restructuring in response to a takeover bid. *Id. at 333-35.*

n178 Marhart, *18 Del. J. Corp. L. at 740.*

n179 Marhart, *18 Del. J. Corp. L. at 336* (citing *Kelly, 254 A.2d at 71).*

n180 See note 72.

n181 Marhart, *18 Del. J. Corp. L. at 336.*

n182 In a not entirely dissimilar case decided just a few months before Marhart, the court of chancery declined to dismiss claims of breach of fiduciary duty of disclosure brought on behalf of a class of stockholders who purchased stock in a dividend reinvestment plan following allegedly material misstatements or omissions in SEC periodic reports. Wiener v. Southern Co., *18 Del. J. Corp. L. 372, 381-82 (1993).* As the court described the matter, however, the denial of the motion to dismiss may have resulted from defendants' failure to articulate and define a basis for dismissal under Delaware law, rather than from the court's conviction that a fiduciary duty claim had been established. *Id. at 382.*

n183 1990-1991 Fed. Secur. L. Rptr. (CCH) paragraph 95,668 (Del. Chanc. Dec. 4, 1990).

n184 As the court explains:

Since the company did not seek the vote of the shareholders, offer them an exchange, or otherwise seek any action from them, the only possible breach of candor claim would necessarily rest upon the existence of a duty to inform the market accurately of material developments. No Delaware case establishes such a duty to my knowledge and, in my opinion, no such duty exists. The state law duty of candor arises when the board elects to or has a duty to seek shareholder action; in that setting the board is under a duty to make shareholder action meaningful by supplying information relevant to the question presented. If the board does not seek shareholder action at a meeting, through consent, in a tender or exchange offer, or otherwise, it has, in my opinion, no distinctive state law duty to disclose material developments with respect to the company's business.

Id. at 98,131-32.

n185 Id. at 98,132 ("There are good business reasons to permit the company to treat material information confidentially."). Similar logic has persuaded courts that issuers are under no federal law duty to disclose material information in the absence of an explicit affirmative disclosure obligation, or when necessary to make a disclosure not materially misleading. See generally Brown, Corporate Disclosure section 3.01 at 3-3 (cited in note 22); Marc I. Steinberg and Robin M. Goldman, Issuer Affirmative Disclosure Obligations--An Analytical Framework for Merger Negotiations, Soft Information and Bad News, *46 Md. L. Rev. 923 (1987).*

n186 See text accompanying notes 172-76.

n187 One could, alternatively, accommodate a legitimate business need for preserving the confidentiality of material information by requiring disclosure of all material information, subject to the right of directors, in their business judgment, to refrain from disclosure when they make a considered determination that disclosure would be contrary to the best interests of the corporation and its stockholders. See Brown, Corporate Disclosure section 9.03[7] at 9-26 and section 9.04 at 9-28 (cited in note 22).

n188 *Rettinger v. Pierpoint, 145 Neb. 161, 15 N.W.2d 393, 412 (1944)* (" 'It is the duty of a trustee to fully inform the cestui que trust of all facts relating to the subject-matter of the trust which come to the knowledge of the trustee and which are material for the cestui que trust to know for the protection of his interests.' ") (quoting *First Trust Co. v. Carlsen, 261 N.W. 333 (Neb. 1935)).* Moreover, the *Restatement (Second) of Trusts section 173* cmt. a (1959) provides:

Even if the trustee is not dealing with the beneficiary on the trustee's own account, he is under a duty to communicate to the beneficiary material facts affecting the interest of the beneficiary which he knows the beneficiary does not know and which the beneficiary needs to know for his protection in dealing with a third person with respect to his interest. Thus, if the beneficiary is about to sell his interest under the trust to a third person and the trustee knows that the beneficiary is ignorant of facts known to the trustee which make the interest of the beneficiary much more valuable than the beneficiary believes it to be the trustee is under a duty to the beneficiary to inform him of such facts.

See also Donald C. Langevoort, Fraud and Deception by Securities Professionals, *61 Tex. L. Rev. 1247, 1250 n.15 (1983)* ("Among a fiduciary's standard 'form' duties are the duties to . . . give information needed by the principal."); Brown, Corporate Disclosure section 9.04 at 9-29 (cited in note 22) (noting that since "the duty of candor arises out of a fiduciary's obligation to shareholders," limiting the obligation to avoiding false or misleading statements and omissions, rather than extending it to require affirmative disclosures of material facts, "does not follow analytically").

n189 *606 A.2d 75 (Del. 1992).*

n190 *Id. at 79.*

n191 These amendments included provisions defining qualifications for service on the board, and imposing a 75% stockholder vote requirement for new issuances of common stock. Stroud v. Grace, *16 Del. J. Corp. L. 1588, 1593-94 (Del. Chanc. 1991).*

n192 *Id. at 1597.*

n193 Unlike the Model Business Corporation Act and the corporate statutes of several states, the Delaware General Corporation Law does not provide an appraisal remedy in respect of amendments to the certificate of incorporation. Compare, *8 Del. Code Ann., sections 242* and 262(b) with 3 Model Bus. Corp. Act Ann. section 13.02(4) (noting that thirty-six states allow appraisal rights in connection with at least certain charter amendments).

In the charter amendment context, the basic relevant facts--namely, what the proposed amendment says--are ordinarily available to stockholders. This context is distinguishable from the context of a cash-out merger, where the minority stockholders, usually lacking access to internal corporate performance and projection data, are at an informational disadvantage in evaluating whether the merger price is fair, and whether to seek statutory appraisal or other post-merger relief. See *In re USA Cafes, L.P. Litigation, 600 A.2d 43, 54 (Del. Chanc. 1991)* ("Because the Prospectus itself discloses that a shareholder vote was neither necessary nor sought on the reorganization of the Nevada corporation, I will dismiss the state law breach of duty of candor claims made with respect to it. Neither plaintiffs nor any class member could have been injured by the alleged defect as they had neither a right to vote nor a right to dissent and seek appraisal."). But see *Shell Petroleum, 606 A.2d at 114* (holding that a majority stockholder effecting a short-form merger "bears the burden of showing complete disclosure of all material facts relevant to a minority shareholder['s] decision whether to accept the short-form merger consideration or seek an appraisal"); *Kahn v. Household Acquisition Corp., 591 A.2d 166, 171 (Del. 1991)* (holding that under Alaska law, an 88.4% stockholder acquiring minority shares in a merger owes a fiduciary duty to disclose material facts, despite ability to satisfy stockholder vote requirement unilaterally); Seagraves v. Urstadt Property Co., Inc., 1996 Del. Chanc. LEXIS 36, *18 (Apr. 1, 1996) ("Delaware law imposes a fiduciary obligation to disclose all material information that would affect a minority stockholder's decision whether to accept the merger consideration or to seek an appraisal or other available litigation remedy."); In re Radiology Associates, Inc. Litigation, 1990 Del. Chanc. LEXIS 58, *34 (May 16, 1990) ("Shareholders . . . rely on directors meeting their duty of candor in electing to accept the merger consideration, seek appraisal or seek an individual post-merger action."); Glassman v. Wometco Cable TV, Inc., 1989 Del. Chanc. LEXIS 1, *1 (Jan. 6, 1989).

n194 *Stroud v. Milliken Enterprises, Inc., 552 A.2d 476, 479-80 (Del. 1989).*

n195 *Id. at 480* ("When a board of directors 'is required or elects to seek shareholder action,' it is under a duty 'to disclose fully and fairly pertinent information within the board's control.' ") (quoting *Lacos Land, 517 A.2d at 279).*

n196 Id.

n197 Stroud, *16 Del. J. Corp. L. at 1608* ("The duty of complete candor cannot be avoided by the directors by a decision not to solicit proxies and to merely comply with the statutory notice provisions of 8 Del. C. sections 222 and 242.").

n198 *Id. at 1611.*

n199 *Id. at 1610.* This approach may have stemmed from the court's acceptance of the corporation's proprietary view that preserving the confidentiality of its internal information afforded it a competitive advantage. The court explained that "confidential information . . . is generally not disclosed in proxy materials." *Id. at 1610-11.* A similar justification for rejecting an affirmative duty of disclosure had previously been articulated by the court of chancery in Raskin, 1990-1991 Fed. Secur. L. Rptr. (CCH) paragraph 95,668. See note 185 and accompanying text.

n200 *Defendants Below-Appellees/Cross-Appellants' Answering Brief on the Appeal and Opening Brief on Their Cross-Appeal at 28-29, Stroud v. Grace, 606 A.2d 75 (Del. 1992)* (on file with the Author).

n201 Id. at 29. It is unclear what "additional information," if any, was required to be disclosed at the stockholder meeting under defendants' exposition. In all events, defendants acknowledged--perhaps overbroadly, and certainly without citation to any authority--that "when management undertakes to communicate with stockholders, through proxy statements or otherwise, then usual fiduciary duties of candor attach requiring communications that are sufficiently accurate and full not to be misleading." Id.

n202 *552 A.2d at 479.* In its subsequent opinion, the court explained that this earlier pronouncement, however emphatic it might have seemed, could not have established a "new substantive principle of law" because, in light of the basis for the earlier dismissal for lack of ripeness, it "would have amounted to the issuance of an impermissible advisory opinion." *Stroud, 606 A.2d at 86.*

n203 *Id. at 84-85.* What the court characterized as "novel" in one breath, however, was repeated, in another breath, as "the well-recognized proposition that directors of Delaware corporations are under a fiduciary duty to disclose fully and fairly all material information within the board's control when it seeks shareholder action." *Id. at 84.*

The court's opinion subsequently recharacterized the duty as requiring that the board of directors "disclose fully and fairly all material facts within its control that would have a significant effect upon a stockholder vote." *Id. at 85* (emphasis added). If anything was novel, it was the probably unintended adoption in this latter formulation of a reliance/causation requirement, under which the stockholder who is complaining of a breach of disclosure duty must establish that the omitted fact would have had "a significant effect upon a stockholder vote." That is hardly a faithful reading of TSC Industries, which the Delaware Supreme Court ostensibly embraces, but which rejected such a stringent reliance/causation requirement. *Stroud, 606 A.2d at 84-85.*

n204 *Id. at 85* (citing *8 Del. Code Ann. sections 222(a),* 242(b)(1)).

n205 Id.

n206 *Id. at 86.*

n207 Id.

n208 See, for example, *Shell Petroleum, 606 A.2d at 112* (involving a tender offer by a majority stockholder); *Kirby Lumber, 413 A.2d at 137* (regarding an information statement used in a short-form merger); *Lynch, 383 A.2d at 278* (involving a tender offer by a majority stockholder); *Lank, 224 A.2d at 242* (involving a purchase of stock).

n209 *Stroud, 606 A.2d at 84.*

n210 *Cahall, 114 A. at 234.* To be sure, the case did involve a stockholder meeting in which shares were represented by proxy, *id. at 238-39*, but that meeting related to a transaction--a proposed sale of assets--distinct from the transactions to which the court's holdings regarding disclosure duties in ratification were directed. See notes 272 and 276.

n211 The Lewes Fisheries Company involved in the Cahall case had only 2,855 outstanding voting shares, *Cahall, 114 A. at 236,* as compared to the over 3,500,000 outstanding shares of Milliken & Company. See *Defendants Below-Appellees/Cross-Appellants' Answering Brief on the Appeal and Opening Brief on Their Cross-Appeal at 4, Stroud v. Grace, 606 A.2d 75 (Del. 1992)* (on file with the Author).

n212 *Stroud, 606 A.2d at 86-87.*

n213 There is nothing that limits the use of proxies, or their solicitation, to public companies. Indeed, the directors of Milliken & Company had begun to solicit proxies in support of a set of proposed charter and by-law amendments that were subsequently withdrawn. *Id. at 79-80.*

Before Stroud was decided, one scholar had concluded that "under Delaware's duty of candor standard, the stockholders of both public and close corporations should be subject to the same duty of disclosure." Pease, *14 Del. J. Corp. L. at 479-80* (cited in note 22). Stroud was at best imprecise in its rejection of that conclusion.

n214 The only conceivable rationale is that stockholders who attend the meeting in person will be able to hear from or question management about the proposal before the vote is taken. As the lower court in Stroud recognized, however, that option is a poor substitute for the opportunity to review and consider written information about a proposal in advance of the meeting. *16 Del. J. Corp. L. at 1611.*

n215 See Part III.A.

n216 The disclosure duty discussion in Stroud has another puzzling aspect. That entire discussion occurred in the context of determining whether the stockholders of Milliken & Company effectively ratified the challenged charter amendments and "placed the burden of proof on the challenger." *Stroud, 606 A.2d at 83.* See also *id. at 90* (after finding "no breach of any fiduciary duty in connection with the shareholder vote at the 1989 annual meeting," holding that the stockholders "effectively ratified the board's action" and "shifted the burden of proof to the plaintiffs to prove that the transaction was unfair"). One might fairly ask why it was appropriate to evaluate stockholder ratification initially. If the directors and controlling stockholders had no conflict of interest regarding the proposed amendments--and the court specifically found that no entrenchment motive existed, *id. at 83*--those proponents of the transaction had no need for a ratification vote to shift the burden of proof, and there was no cause to examine the directors' actions under any unfavorable burden of proof. See, for example, *Cede & Co., 634 A.2d at 361.* Alternatively, if the controlling stockholders and directors were to have been deemed personally interested in the amendments--not a frivolous claim, since the proposed 75% vote requirement to issue stock effectively prevented the board from making any attempt to dilute the holdings of the controlling stockholders against their will--it seems unlikely at best that the stockholder vote could have resulted in a shift in the burden of proof, for two related reasons. First, the votes of self-interested stockholders--such as the Milliken majority stockholder group, as presumed in this discussion--are ordinarily not counted toward effective ratification. *Fliegler v. Lawrence, 361 A.2d 218, 221 (Del. 1976);* Drexler, Delaware Corporation Law paragraph 15.05[4] at 15-24 (cited in note 30); ALI Principles sections 1.16, 5.10 (cited in note 32). Second, it is highly unlikely that the amendments were approved by a "majority of the minority" ratification vote, which arguably could have shifted the burden of proof. See *Weinberger, 457 A.2d at 703.* If the proponents owned over 56% of the outstanding shares (their precise percentage of ownership is not a matter of public record), less than a majority of the minority shares would have voted for the challenged amendments, since only 78% of the outstanding shares were voted in favor of the amendments. *Stroud, 606 A.2d at 80-81.*

Therefore, the only analytically supportable explanation for the court's extended inquiry into the fiduciary duty of disclosure is an implicit holding that if a material fact had not been disclosed to the stockholders, the charter amendments could have been invalidated, notwithstanding any presumption of validity attaching to the board's action in approving their submission to a stockholder vote, simply and solely because of the breach of the disclosure duty.

The court's 1996 decision in Williams v. Geier reinforces this view. After affirming that a disinterested board's recommendation of a "tenure voting" recapitalization plan was "protected by the business judgment rule," *671 A.2d at 1378,* the court, closely tracking its analysis in Stroud, nonetheless went on to examine whether "all material facts relevant to the transaction were disclosed." *Geier, 671 A.2d at 1378, 1379.*

n217 *Stroud, 606 A.2d at 87.*

n218 Id. That "shift" of disclosure to the stockholder meeting is puzzling, as a matter of timing, in view of the court's treatment elsewhere in the opinion of the handling of material but confidential information. According to that treatment, the board has a burden of proving (1) "complete disclosure of material facts," and (2) if such facts include confidential information, that the stockholders have been "given notice and opportunity . . . to execute a reasonable confidentiality agreement" and thereby gain access to information. *Id. at 89.* How all of this is supposed to happen if the disclosure obligation does not require that information be provided until the stockholder meeting is unclear. Perhaps the directors, anticipating a duty to disclose confidential information at the meeting itself, must alert stockholders to that possibility before the meeting in sufficient time to permit them to sign confidentiality agreements and be given the confidential information at the meeting. It is also unclear from Stroud, however, whether stockholders who decline or fail to sign such confidentiality agreements may or must be excluded from the stockholder meeting so that the material confidential information can be presented in a sort of executive session, to the stockholders who do execute such agreements.

n219 *Id. at 87-88.*

n220 See note 360 (discussing *Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083 (1991)).*

n221 *621 A.2d 773 (Del. 1993).*

n222 *Id. at 777.*

n223 *Id. at 778.*

n224 *Id. at 779, 783.*

n225 *Id. at 779* (holding irrelevant "the sincerity of [the directors'] subjective beliefs" and noting that materiality, not motive, is dispositive: "a material omission is not rendered immaterial simply because the party making the omission honestly believes it insignificant").

n226 See *Joint Answering Brief of Defendants Below-Appellees, Zirn v. VLI Corp. 621 A.2d 773 (Del. 1993)* (on file with the Author).

n227 After concluding in broad abstraction that a director's duty "to disclose to shareholders all material facts bearing upon a merger vote arises under the duties of care and loyalty," *Zirn, 621 A.2d at 778*, the court concluded--despite the absence of any evidence of self-dealing on the part of the VLI directors--that any breach of fiduciary disclosure duty necessarily arose under the duty of loyalty, and the exculpatory charter provision therefore could not, under the authorizing statute (*8 Del. Code Ann. section 102(b)(7)*), permissibly preclude liability for damages on account of such a breach. *Id. at 783.*

This aspect of the court's opinion was questionable, and was in fact pointedly questioned. Bradford D. Bimson, Comment, Zirn v. VLI Corp.: The Far-Reaching Implications of Loquacity, *19 Del. J. Corp. L. 1067, 1116 (1994).* In any event, the Delaware Supreme Court's decision in Arnold dispels any notion that a failure to disclose necessarily precludes director reliance upon an exculpatory charter provision adopted pursuant to statute.

n228 *Zirn, 621 A.2d at 780.* On remand, the court of chancery found that the undisclosed information at issue was not material, under applicable legal standards. Zirn v. VLI Corp., 1995 Del. Chanc. LEXIS 74, *12-14 (June 12, 1995). The threat of damages liability may not have been a great concern to the individual directors, who may well have had a right to require the continuing corporation to indemnify them with respect to any money damages that might have been assessed against them. See *8 Del. Code Ann. section 145(a)*, (f); Drexler, Delaware Corporation Law paragraph 16.02[2] at 16-6 (cited in note 30); Balotti and Finkelstein, Delaware Law of Corporations section 4.16 at 4-348 (cited in note 30).

n229 *650 A.2d 1270 (Del. 1994).*

n230 Letter from Cathy L. Howard, Assistant Clerk, to counsel in Arnold v. Society for Savings Bancorp, Inc. (Aug. 5, 1994) (on file with the Author).

n231 Id.

n232 Counsel were allowed just 15 pages to argue four separate issues. Id.

n233 See text accompanying note 39.

n234 See text accompanying notes 160-62.

n235 See cases cited in note 152. *Opening Supplemental Brief of Plaintiff-Below/Appellant at 3-8, Arnold v. Society for Savings Bancorp, Inc., 650 A.2d 1270 (Del. 1994)* (on file with the Author).

n236 See note 117.

n237 *Supplemental Brief of Defendants/Appellees at 4, Arnold v. Society for Savings Bancorp, Inc., 650 A.2d 1270 (Del. 1994)* (on file with the Author).

n238 *Arnold, 650 A.2d at 1276.*

n239 *Id. at 1276-77* (citing, in addition to *Weinberger, Van Gorkom, Stroud and Zirn, Tri-Star, 634 A.2d at 331-32, 334; Cede & Co., 634 A.2d at 373; Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 846 (Del. 1987); Rosenblatt, 493 A.2d at 936, 944-45).*

n240 Id. at 1277.

n241 Id. at 1286-88. The court read section 102(b)(7) of the Delaware General Corporation Law as unambiguously permitting elimination by charter provision of monetary damages liability for all breaches of fiduciary duty, including any fiduciary duty of disclosure, except for breaches of duty identified in the statutory exceptions--"(i) . . . any breach of the director's duty of loyalty to the corporation or its stockholders; and (ii) . . . acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of the law . . . "--which the court found inapplicable. See *8 Del. Code Ann. section 102(b)(7).*

n242 *Arnold, 650 A.2d at 1288 n.36* ("We agree with defendants that, on this record, the single disclosure violation which we have found was consistent only with a good faith omission.").

n243 *Id. at 1277-80.*

n244 *Id. at 1282.*

n245 To be sure, the court's allowance of the possibility that the bid might have been material, *id. at 1277,* indicates a receptivity to the argument that some facts are material and must be disclosed, as a matter of fiduciary duty, without regard to the content or existence of any related disclosure.

n246 Indeed, it was only on remand in the Arnold case that the courts first considered head-on whether the directors' duty of disclosure inheres in and derives to any extent from the statutes requiring notice of meetings to consider fundamental transactions. On remand, the Chancery Court ruled that plaintiff's case arose under a "separate fiduciary duty of disclosure," and that the merger statute "does not require the directors of a corporation to inform the stockholders of all material facts prior to the vote on the merger." Arnold v. Society for Savings Bancorp, Inc., 1995 Fed. Secur. L. Rptr. (CCH) paragraph 98,827, at 92,989 (Del. Chanc. June 15, 1995), aff'd, *678 A.2d 533 (Del. 1996).* The Delaware Supreme Court has affirmed that ruling, holding that "the duty of disclosure is a judicially imposed fiduciary duty which applies as a corollary to the statutory requirements." *Arnold, 678 A.2d at 537.* That ruling flows logically from the narrow reading of the notice statutes in *Stroud, 606 A.2d at 85.*

n247 See, for example, Guido Calabresi, A Common Law for the Age of Statutes 97 (Harvard U., 1982) ("Each judicial decision, at its best, is meant to represent a reasoned attempt to adapt a past set of decisions to a current problem."); Benjamin N. Cardozo, The Nature of the Judicial Process 141 (Yale U., 1921); Charles D. Breitel, The Lawmakers, *65 Colum. L. Rev. 749, 773 (1965).*

n248 Shepherd, Law of Fiduciaries at v (cited in note 49).

n249 Id.

n250 See, for example, id.; P.D. Finn, Fiduciary Obligations (Carswell, 1977); Tamar Frankel, Fiduciary Relationships in the United States Today, in Donovan W. M. Waters, ed., Equity, Fiduciaries and Trusts 173 (Carswell, 1993); John H. Langbein, The Contractarian Basis of the Law of Trusts, *105 Yale L. J. 625 (1995);* Robert Cooter and Bradley J. Freedman, The Fiduciary Relationship: Its Economic Character and Legal Consequences, *66 N.Y.U. L. Rev. 1045 (1991);* Robert Flannigan, The Fiduciary Obligation, 9 Oxford J. Legal Stud. 285 (1989); P.D. Finn, The Fiduciary Principle, in T.G. Youdan, ed., Equity, Fiduciaries and Trusts 1 (Carswell, 1989); Deborah DeMott, Beyond Metaphor: An Analysis of Fiduciary Obligation, *1988 Duke L. J. 879;* Hetherington, *22 Wake Forest L. Rev. at 9* (cited in note 37); Tamar Frankel, Fiduciary Law, *71 Cal. L. Rev. 795 (1983);* Ernest J. Weinrib, The Fiduciary Obligation, *25 U. Toronto L. J. 1 (1975);* L. S. Sealy, Some Principles of Fiduciary Obligation, *1963 Cambridge L. J. 119;* L. S. Sealy, Fiduciary Relationships, *1962 Cambridge L. J. 69;* Austin W. Scott, The Fiduciary Principle, *37 Cal. L. Rev. 539 (1949).*

n251 Cooter and Freedman, *66 N.Y.U. L. Rev. at 1045-46* (cited in note 250). See also Flannigan, 9 Oxford J. Legal Stud. at 286 (cited in note 250) ("Judicial and academic conclusions, however, have been tentative. There is much that remains obscure."). See also Clark, Agency Costs in Pratt and Zeckhauser, eds., Principals and Agents at 71 (cited in note 37) ("Perhaps because the subject matter is so sprawling and elusive, there has been little legal analysis of the fiduciary concept that is simultaneously general, sustained, and astute.").

n252 It cannot be accepted that Darwinian market forces inexorably lead the courts to articulate comprehensive fiduciary disclosure principles that minimize agency costs and thereby best serve the needs and expectations of the parties to commercial relationships. Clark, Agency Costs in Pratt and Zeckhauser, eds., Principals and Agents at 63-64 (cited in note 37) (acknowledging that "the more elementary features of the corporate form . . . result from (fairly slow, crude) processes of legal evolution that favor rules that reduce transaction costs," but questioning whether market forces meaningfully shape the finer issues of fiduciary doctrine). The normative value of such a market-oriented view is at best questionable, where the empirical effects of nuances of state fiduciary law rules on stock prices, firms' cost of capital, and incorporation decisions are so very difficult to isolate. The baffling intricacy of the problems posed by this approach is painstakingly and, ultimately, frustratingly explored in Elliott J. Weiss and Lawrence J. White, Of Econometrics and Indeterminacy: A Study of Investors' Reactions to "Changes" in Corporate Law, *75 Cal. L. Rev. 551 (1987).* They conclude that "investors' well-documented failure to react to announcements of reincorporation decisions, like their failure to react to the judicial decisions we studied, may well reflect little more than their judgments about the indeterminacy of corporate law." *Id. at 602.* They urge us, in evaluating corporate law issues, to explore instead "the normative, historical, and institutional factors involved." *Id. at 603.*

n253 The directors' power to manage the corporation's assets is explicit under many corporate statutes. See, for example, *8 Del. Code Ann. section 141(a)*; Model Bus. Corp. Act Ann. section 8.01(b). Less explicit under statute, but just as clear as a matter of law, is the stockholders' residual interest in the assets of the corporation. Hetherington, *22 Wake Forest L. Rev. at 15* (cited in note 37). It is thus commonplace that directors serve as fiduciaries, accountable to the stockholders, in respect of the management of the corporation's assets. Mitchell, *43 Duke L. J. at 430* (cited in note 99); Flannigan, 9 Oxford J. Legal Stud. at 317 (cited in note 250); DeMott, *1988 Duke L. J. at 908* (cited in note 250); Sealy, *1963 Cambridge L. J. at 74-75* (cited in note 250).

n254 See, for example, ALI Principles section 4.01(e) cmt. b at 173-74 (cited in note 32).

n255 See, for example, *8 Del. Code Ann. section 251(c)*; Model Bus. Corp. Act Ann. section 11.03.

n256 See, for example, *8 Del. Code Ann. section 242(b)*; Model Bus. Corp. Act Ann. section 10.03(b).

n257 See, for example, *8 Del. Code Ann. section 271(a)*; Model Bus. Corp. Act Ann. section 12.02(b).

n258 See, for example, *8 Del. Code Ann. section 275(b)*; Model Bus. Corp. Act Ann. section 14.02(b).

n259 *17 C.F.R. section 240.14e-2*.

n260 In corporate decision-making, isolated stockholders cannot efficiently gather the pertinent information, so "some sort of collective information-generating agency is necessary. In a firm, the managers serve this function, and consequently it is unlikely that voters would think themselves able to decide with greater insight than the managers do. No wonder voters delegate extensively to managers and almost always endorse their decisions." Easterbrook and Fischel, Economic Structure at 66-67 (cited in note 3). See also Michael P. Dooley, Two Models of Corporate Governance, *47 Bus. Law. 461, 467-68 (1992)* (citing Kenneth J. Arrow, The Limits of Organization 68-69 (Norton, 1974)).

n261 Finn, Fiduciary Principle at 3 (cited in note 250).

n262 As to corporate directors, see *Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668, 684 (Mich. 1919);* ALI Principles section 2.01(a) at 70 (cited in note 32); Hetherington, *22 Wake Forest L. Rev. at 15* (cited in note 37). One cannot articulate the widely accepted view that directors' overriding responsibility is to maximize stockholder value, however, without acknowledging the depth of the debate on the subject. See, for example, Lawrence E. Mitchell, A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes, *70 Tex. L. Rev. 579 (1992);* David Millon, Redefining Corporate Law, *24 Ind. L. Rev. 223 (1991).*

n263 See, for example, Langbein, *105 Yale L. J. at 655-56* (cited in note 250).

n264 Cooter and Freedman, *66 N.Y.U. L. Rev. at 1074* (cited in note 250); Hetherington, *22 Wake Forest L. Rev. at 11* (cited in note 37); Alison Grey Anderson, Conflicts of Interest: Efficiency, Fairness and Corporate Structure, *25 UCLA L. Rev. 738, 740 (1978);* Weinrib, *25 U. Toronto L. J. at 15* (cited in note 250).

n265 Paul G. Mahoney, Mandatory Disclosure as a Solution to Agency Problems, *62 U. Chi. L. Rev. 1047, 1090 (1995);* Cooter and Freedman, *66 N.Y.U. L. Rev. at 1052-56, 1074* (cited in note 250); Frankel, *71 Cal. L. Rev. at 831-32* (cited in note 250); Anderson, *25 UCLA L. Rev. at 740* (cited in note 264).

n266 See, for example, *Briggs v. Spaulding, 141 U.S. 132, 147 (1891); Cede & Co., 634 A.2d at 367-68;* Model Bus. Corp. Act Ann. section 8.30(a); ALI Principles section 4.01(a) (cited in note 32).

n267 See, for example, *Van Gorkom, 488 A.2d at 873;* Dooley, *47 Bus. Law. at 471-72* (cited in note 260); Joseph Bishop, Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers, *77 Yale L. J. 1078, 1099-1100 (1968).*

n268 See, for example, *Joy v. North, 692 F.2d 880, 885-86 (2d Cir. 1982); Cede & Co., 634 A.2d at 360-61*.

n269 *Joy, 692 F.2d at 886;* Easterbrook and Fischel, Economic Structure at 94-100 (cited in note 3); Cooter and Freedman, *66 N.Y.U. L. Rev. at 1075* (cited in note 250).

n270 This proposition is a corollary of the fundamental division of corporate managerial power as between directors and stockholders. See note 253.

n271 See note 37 and text accompanying note 263.

n272 See, for example, *Weinberger, 457 A.2d at 710; Guth v. Loft, Inc., 5 A.2d 503 (Del. 1939).* In *Cahall v. Lofland, 114 A. 224 (Del. Chanc. 1921)*, the president/director, while acting as an agent for a purchaser of corporate assets, failed to inform stockholders, in connection with their vote to approve the asset sale, that the buyer had already contracted to resell the assets at a substantial profit. The court observed:

From this one is reluctantly driven to the conclusion that such an advantage was taken of the ignorance of the stockholders of facts above referred to, which were concealed from them by one whose duty it was to inform them of these facts, that they did not then have before them data from which to make an intelligent choice, or protect themselves from the effect of the duplicity of their trusted representative.

Id. at 239. See also *Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928);* Hetherington, *22 Wake Forest L. Rev. at 10-11* (cited in note 37); Frankel, *71 Cal. L. Rev. at 829-32* (cited in note 250).

n273 Model Bus. Corp. Act Ann. section 8.61(b); *8 Del. Code Ann. section 144*; *Oberly, 592 A.2d at 467; Merritt v. Colonial Foods, Inc., 505 A.2d 757, 763-64 (Del. Chanc. 1986);* Harold Marsh, Jr., Are Directors Trustees? Conflict of Interest and Corporate Morality, *22 Bus. Law. 35, 36-38 (1966).*

n274 See notes 95-97, 108 and accompanying text.

n275 The level of director interest in a transaction sufficient to trigger application of the traditional duty of loyalty, and concomitant duty of disclosure, is not precisely definable. The Delaware Supreme Court has identified defensive actions tending to perpetuate directors' control as giving rise to an "omnipresent specter" of director self-interest. The drafters of the Model Business Corporation Act, however, have excluded defensive conduct not involving a direct personal financial benefit to the director from the definition of director conflict of interest transactions. Compare *Unocal, 493 A.2d at 954,* with Model Bus. Corp. Act Ann., Official Comment to section 8.60 ("Director's Conflicting Interest Transaction"). The recent opinion in Williams v. Geier somewhat clarifies Delaware law on this point, holding that the enhanced judicial scrutiny required by Unocal applies "only where a board unilaterally (i.e., without stockholder approval) adopts defensive measures in reaction to a perceived threat." *Williams, 671 A.2d at 1376.* Accordingly, where directors do not adopt defensive measures unilaterally--as where director action is limited to recommending defensive charter provisions for approval by stockholders--Delaware law appears to reject the claim that the directors are acting out of self-interest and must therefore bear some burden, as prescribed by Unocal, of presenting evidence of the reasonableness of their investigation of and response to a threat to corporate interests. Yet in Santa Fe the court found that stockholder approval of a merger did not constitute approval of unilateral director actions taken to promote the merger, and did not relieve directors of their burden under Unocal to establish the reasonableness of their perception of a threat to corporate policy and the reasonableness of their unilateral actions in relation to that threat. *Santa Fe, 669 A.2d at 68.*

n276 See Roberts v. General Instrument Corp., 1990 Fed. Secur. L. Rptr. (CCH) paragraph 95,465, at 97,405-07 (Del. Chanc. Aug. 13, 1990) (evaluating sufficiency of disclosure in tender offer by buyout firm affiliated with management); In re Shoe-Town, Inc. Stockholders Litigation, 1990 Del. Chanc. LEXIS 14, *27 (Feb. 12, 1990); In re Fort Howard Corp. Shareholders Litigation, 1988 Del. Chanc. LEXIS 110, *45-46 (Aug. 8, 1988); *Cahall, 114 A. at 237* (finding a buyer of corporate assets liable for aiding and abetting president/director's concealment of material fact in securing stockholder approval of asset sale).

n277 See Shoe-Town, 1990 Del. Chanc. LEXIS 14 at *26. A disinterested director may be charged with breach of a fiduciary duty if she approves, with the requisite lack of care, a transaction between the corporation and another director. Although not personally interested in the transaction, such a director could invoke stockholder ratification as a defense, and would have to establish the same full disclosure, as a predicate to effectiveness of the ratification, that the interested director would have to establish to defend the transaction.

n278 See *Restatement (Second) of Torts section 551(2)(b)* & cmt. g (1977) (discussing the common law disclosure duty of completeness); *Issen v. GSC Enterprises, Inc., 538 F. Supp. 745, 751 (N.D. Ill. 1982):* "The common law of torts also provides that when a party makes a materially incomplete disclosure, that party has the duty to disclose whatever additional material information is necessary to prevent the partial disclosure from misleading the recipient." *Id. at 751.* See also *First Virginia Bankshares v. Benson, 559 F.2d 1307, 1313 (5th Cir. 1977).* Compare *In re General Motors Class E Buyout Securities Litigation, 694 F. Supp. 1119, 1129 (D. Del. 1988)* (criticizing Issen but acknowledging a duty of completeness under SEC Rule 10b-5, *17 C.F.R. section 240.10b-5*).

n279 See, for example, *Arnold, 650 A.2d at 1280-81* (applying a duty of completeness as part of fiduciary disclosure duty in recommending a merger); *Lynch, 383 A.2d at 281.* At least one court has suggested, however, that the fiduciary duty of disclosure does not require self-dealing managers to disclose their "consideration of the price at which they will buy or sell and how they would finance a purchase or invest the proceeds of a sale." Kahn v. Tremont Corp., 196 Del. Chanc. LEXIS 40, *55 (Mar. 21, 1996, revised Mar. 27, 1996).

n280 See, for example, *8 Del. Code Ann. section 144(a)(1)*, (2); ALI Principles section 5.02(a)(1) (cited in note 32).

n281 The directors' conflict frequently is revealed in a complete description of the transaction, as, for example, where stock or a stock option is issued to directors individually. See, for example, *Michelson, 407 A.2d at 211; Cahall, 114 A. at 224.* In that setting, it is difficult to imagine that the transaction could be described completely without identifying the party to whom the stock or option is being issued. Where the directors' conflict is more attenuated, however--as in the case where stock is issued to a corporation of which the directors are officers or significant stockholders--the transaction (including the identity of stock purchaser) could perhaps be described, consistent with a duty of completeness, without revealing the directors' conflict. Such completeness, however, would not satisfy the demands of fiduciary law.

n282 See *Ohio Drill & Tool Co. v. Johnson, 498 F.2d 186, 195 (6th Cir. 1974)* ("When a cloak of secrecy is raised concealing the self-dealing transaction, the directors must prove that nothing is amiss behind the shield."); *Shlensky v. South Parkway Building Corp., 19 Ill. 2d 268, 166 N.E.2d 793, 812 (Ill. 1960);* Balotti and Finkelstein, 1 Delaware Law of Corporations section 4.9 at 4-225 n.745 (cited in note 30): "If the price is fair, inadequate disclosure may not necessarily establish an independent basis for invalidating an interested transaction. As long as the transaction is fair within the meaning of Weinberger, the transaction should be upheld." Id. at 4-225 n.745. Compare *State ex rel. Hayes Oyster Co. v. Keypoint Oyster Co., 64 Wash. 2d 375, 391 P.2d 979, 984 (1964)* (nondisclosure of self-dealing may per se render the transaction voidable); ALI Principles section 5.02(a)(1) at 241-42, n.6 (cited in note 32); Mitchell, *43 Duke L. J. at 438-39* (cited in note 99); George D. Hornstein, 1 Corporation Law and Practice section 439 at 544 (West, 1959) ("Nondisclosure by an interested director may itself constitute unfairness."). Even if some disclosure of self-dealing were required to avoid voidability per se, however, there is no reason to mandate that such disclosure necessarily be made to the stockholders, as opposed to disinterested directors.

In any event, secrecy would surely not enhance proof of entire fairness. Disclosure is a significant part of what has been described as the "fair dealing" element of entire fairness. *Weinberger, 457 A.2d at 711.* Moreover, even if fiduciary law does not mandate disclosure to stockholders of self-dealing, it encourages such disclosure by endowing informed stockholder consent to self-dealing with curative power. See note 101.

n283 See Form 10-K, Item 13, as prescribed under *17 C.F.R. section 249.310*, requiring annual reporting of transactions with management in accordance with Item 404 of Regulation S-K under the Securities Act of 1933. *17 C.F.R. section 229.404*. See also Mahoney, *62 U. Chi. L. Rev. at 1091-93* (cited in note 265).

n284 State corporation statutes do not universally require disclosure of self-dealing transactions or, indeed, any financial or operating information. See 3 Model Bus. Corp. Act Ann. section 16.20 at 16-77 to 16-82. For example, unlike the Model Business Corporation Act (sections 16.20-.21), the Delaware statute is devoid of any requirement of regular reporting of corporate business. Id. at 16-82. Discovery by outside stockholders of management self-dealing must be initiated and pursued by the stockholder under statutory rights of inspection. See, for example, *8 Del. Code Ann. section 220(b)*; *Rales v. Blasband, 634 A.2d 927, 934 n.10 (Del. 1993).* In light of the costs of monitoring, "it is likely that in a public corporation there will be less shareholder monitoring expenditures than would be optimum from the point of the shareholders as a collectivity." Bird v. Lida, Inc., 1996 Del. Chanc. LEXIS 41, *9 (Apr. 4, 1996). Thus, Professor Mahoney argues for a mandatory disclosure policy applicable to public companies, albeit a policy limited to "disclosure of executive compensation and self-dealing on an ongoing basis." Mahoney, *62 U. Chi. L. Rev. at 1091-92* (cited in note 265). Mahoney contends that such disclosure would ultimately be the norm in any event in a privately ordered system because of its efficiency in reducing agency costs. Id.

n285 See text accompanying note 102.

n286 *Weinberger, 457 A.2d at 714;* ALI Principles section 7.18(a) (cited in note 32). See also notes 318-22 and accompanying text.

n287 See Kahn v. Lynch Communications Systems, Inc., 1995 Del. Chanc. LEXIS 44, *5 (Apr. 17, 1995), aff'd, *669 A.2d 79 (Del. 1995)* (holding that despite coercion of special committee by controlling stockholder, merger was entirely fair in part because the special committee was able to engage advisors who provided assistance in negotiating and evaluating alternative transactions).

n288 See Part III.B. Stock purchases by corporate fiduciaries, at least where the purchaser (and his fiduciary status) are known to the selling stockholder, are the prevailing context in which the case law addresses fiduciary issues. While much of what is said here could apply to the case in which a director sells her stock directly to an outside stockholder on the basis of inside information in order to avoid a loss, that factual context is at best unusual. Hence, the discussion here speaks of purchases of stock by the fiduciary from the outside stockholder, rather than sales of stock by the fiduciary to the outside stockholder.

n289 See *Eisenberg v. Chicago Milwaukee Corp., 537 A.2d 1051, 1057 (Del. Chanc. 1987)* (holding that in the context of a self-tender offer approved by directors owning a controlling block of stock, "the interest of the corporate offeror (qua buyer) is to pay the lowest price possible; the interest of the stockholders (qua sellers) is to receive as high a price as possible").

n290 See, for example, Michael Conant, Duties of Disclosure of Corporate Insiders Who Purchase Shares, *46 Cornell L. Q. 53, 55 (1960).* Such a role is implicated, of course, where the corporation is the purchaser of stock and corporate assets are used to fund the purchase. With this additional underpinning of fiduciary responsibility in place, courts have not hesitated to impose fiduciary duties of disclosure on managers who bring about such stock repurchases. See, for example, *Northern Trust Co. v. Essaness Theatres Corp., 348 Ill. App.*

134, 108 N.E.2d 493 (1952). Northern Trust distinguishes cases where the director purchases stock for his own account, and observes that: "Directors occupy the position of trustees for the stockholders as a body and cannot have or acquire any personal or pecuniary interest in conflict with their duty as such trustees. That is to say, when they act on behalf of the corporation, they occupy the position of trustee to each individual stockholder." Id. at 498. See also *Adams v. Mid-West Chevrolet Corp., 198 Okla. 461, 179 P.2d 147, 156 (Okla. 1946).* One court has suggested, however, that this distinction between corporate repurchases and purchases by a director for her own account is "illogical." *Guy v. Duff and Phelps, Inc., 672 F. Supp. 1086, 1091 (N.D. Ill. 1987).*

n291 *Goodwin v. Agassiz, 283 Mass. 358, 186 N.E. 659, 660 (1933)* (citing "an imposing weight of authority in other jurisdictions" for the proposition that the stock purchaser's director status creates no fiduciary relation to the selling stockholder). See also Finn, Fiduciary Obligations at 65 (cited in note 250); Shepherd, Law of Fiduciaries at 355-56 (cited in note 49); Stephen M. Bainbridge, Incorporating State Law Fiduciary Duties into the Federal Insider Trading Prohibition, *52 Wash. & Lee L. Rev. 1189, 1219 (1995).*

n292 See, for example, *Brophy, 70 A.2d at 7-8; Tarnowski v. Resop, 51 N.W.2d 801, 802-03 (Minn. 1952); Restatement (Second) of Agency sections 388* cmt. c, 395, 404 (1958). See also Conant, *46 Cornell L. Q. at 75* (cited in note 290). Bainbridge questions the reach of these agency principles, but ultimately acknowledges a "trend in the case law . . . towards imposing fiduciary duties on insiders." Bainbridge, *52 Wash. & Lee L. Rev. at 1224-26* (cited in note 291). See also Donald C. Langevoort, Insider Trading and the Fiduciary Principle: A Post-Chiarella Restatement, *70 Cal. L. Rev. 1, 5, 6 n.17 (1982).*

n293 See John C. Coffee, Jr., No Exit? Opting Out, the Contractual Theory of the Corporation, and the Special Case of Remedies, *53 Brooklyn L. Rev. 919, 945-46 (1988);* James D. Cox, Insider Trading and Contracting: A Critical Response to the "Chicago School", *1986 Duke L. J. 628, 637-38 (1986);* Roy A. Schotland, Unsafe At Any Price: A Reply to Manne, Insider Trading and the Stock Market, *53 Va. L. Rev. 1425, 1438-41 (1967).*

n294 See note 290.

n295 See Cox, *1986 Duke L. J. at 656-59* (cited in note 293); Frankel, *71 Cal. L. Rev. at 833, 835* (cited in note 250).

Professor Dooley has argued that the absence of a fiduciary duty of disclosure when directors of public companies purchase stock from outside stockholders is "firmly based on efficiency considerations." Michael P. Dooley, Enforcement of Insider Trading Restrictions, *66 Va. L. Rev. 1, 64 (1980).* Insider trading profits, he argues, provide incentive to managers to develop information useful to the wealth of the enterprise, and which will inure to the benefit of stockholders as a whole, where the managers are unable to acquire any more than a small percentage of the outstanding shares using their inside information. *Id. at 66.* In other words, some hapless public stockholders must be allowed to sell their stock at an unfairly low price, without the benefit of material inside information that the purchasing director may not have expended any effort in acquiring, in order to provide some haphazard, fortuitous inducement to managers generally to gather valuable information so that they and the fortunate non-selling public stockholders can benefit--assuming, of course, that we are not dealing with a management buyout in which all publicly held shares are acquired by insiders. This compensation theory for rejecting a fiduciary disclosure duty has been criticized as "inefficient." Frank H. Easterbrook, Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information, *11 S. Ct. Rev. 309, 332 (1981).* See also Cox, *1986 Duke L. J. at 651-52* (cited in note 293).

n296 *Goodwin, 186 N.E. at 659,* is probably the leading authority in this context. Goodwin, which involved a claim for damages by a stockholder who sold in an impersonal market transaction, must be distinguished, however, from cases in which the corporation, usually in a derivative suit, seeks to recover the director's trading profits. See generally *Frankel v. Slotkin, 984 F.2d 1328, 1336-37 (2d Cir. 1993); National Westminster Bancorp*

NJ v. Leone, 702 F. Supp. 1132, 1139 (D.N.J. 1988); In re ORFA Securities Litigation, 654 F. Supp. at 1449 (D.N.J. 1987); Coleco Securities Litigation, 591 F. Supp. 1488, 1494-95 (S.D.N.Y. 1984); Ferris v. Polycast Technology Corp., 429 A.2d 850, 853 (Conn. 1984); Katz Corp. v. T.H. Canty & Co., 362 A.2d 975, 980 (Conn. 1975); Brophy, 70 A.2d at 5; Diamond v. Oreamuno, 248 N.E.2d 910 (N.Y. 1969). Research has not disclosed any case in which a stockholder selling in the market has successfully invoked fiduciary disclosure duty, as opposed to Rule 10b-5, to recover compensatory damages from a director who concurrently bought stock. In any event, the more recent cases in the Oreamuno line, even while recognizing the existence of a derivative claim of breach of fiduciary duty, have tended to limit recovery to losses sustained by the corporation, if any such losses can be proven, and have declined to authorize recovery of the insider's trading gains. See, for example, *Frankel, 984 F.2d at 1336-37* (stating that the "breach of fiduciary obligation is a tort claim, and thus requires the showing of a duty, a breach, an injury, and causation"); *In re ORFA, 654 F. Supp. at 1457.* See also *Schein v. Chasen, 313 So.2d 739, 746 (Fla. 1975)* (rejecting vicarious tippee liability). Moreover, not all courts even accept the premise that insider trading in the market constitutes a breach of fiduciary duty to the corporation. See, for example, *Freeman v. Decio, 584 F.2d 186 (7th Cir. 1978);* Daisy Systems Corp. v. Feingold, 1989 Fed. Secur. L. Rptr. (CCH) paragraph 94,520, at 93,311 (N.D. Cal. 1988).

As Professor Bainbridge points out, "the American Law Institute's corporate governance project opines that duty to refrain from self-dealing in confidential corporate information exists in both face-to-face and stock exchange transactions." Bainbridge, *52 Wash. & Lee L. Rev. at 1226* (cited in note 291) (discussing ALI Principles section 5.04(a) (cited in note 32)). Bainbridge quickly cautions, however, that "the only citation of support offered by the Reporter for the proposition that this duty extends to secondary market transactions is a 'but see' cite to Goodwin." *Id. at 1226 n.161* (citing ALI Principles section 5.04 at 377 (cited in note 32)).

n297 See note 260.

n298 See note 333.

n299 See Seligman, *73 Geo. L. J. at 1091-93* (cited in note 124) (citing Anthony T. Kronman, Mistake, Disclosure, Information and the Law of Contracts, *7 J. Legal Stud. 1, 11-12 (1978)).*

n300 See note 260.

n301 One cannot proceed further with the analysis of the fiduciary disclosure duty of directors in the stock purchase context without noting the potential significance of state law to the reach of the federal insider trading laws. See, for example, *Dirks v. SEC, 463 U.S. 646, 653 (1983); Chiarella v. United States, 445 U.S. 222, 232 (1980); United States v. Chestman, 947 F.2d 551, 568 (2d Cir. 1991);* Bainbridge, *52 Wash. & Lee L. Rev. at 1268* (cited in note 291) ("The fiduciary duty element required by the federal definition of insider trading should be supplied solely by state corporate law.").

n302 See text accompanying notes 297-300.

n303 See, for example, *Mansfield Hardwood Lumber, 263 F.2d at 754.*

n304 See, for example, *Shell, 606 A.2d at 114; Kahn, 591 A.2d at 171; Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 846 (Del. 1987); Weinberger, 457 A.2d at 711; Lynch, 383 A.2d at 279.*

n305 See note 276.

n306 See note 277. See also *Citron v. Fairchild Camera and Instrument Corp., 569 A.2d 53, 70 (Del. 1989);* ALI Principles section 5.04 at 270-71 (cited in note 32).

n307 *Mansfield Hardwood Lumber, 263 F.2d at 748* (privately negotiated purchase); *Joseph v. Shell Oil Co., 482 A.2d 335 (Del. Chanc. 1984)* (tender offer by majority stockholder); *Weinberger, 457 A.2d 701* (merger conditioned upon vote of majority of minority shares voting).

n308 The Delaware Court of Chancery has held, in fact, that a stockholder who does not tender shares in a self-tender offer lacks standing to challenge the sufficiency of disclosure on a fiduciary duty theory, since no change of control or second-step squeeze-out transaction results from the tender offer, and the stockholder otherwise suffers no cognizable effect. Abajian v. Kennedy, 1992 Del. Chanc. LEXIS 6, *25-26 (Jan. 17, 1992).

n309 See text accompanying note 296.

n310 See, for example, *8 Del. Code Ann. sections 253(d)*, 262(b).

n311 See note 193.

n312 *Eisenberg, 537 A.2d at 1057-58* (pointing out that in a stock repurchase, directors "are acting both as the representatives of the corporate offeror and as fiduciaries for the shareholder offerees . . . necessarily giving rise to a potential conflict of the directors" justifying an "onerous disclosure standard") (citing *Blanchette v. Providence & Worcester Co., 428 F. Supp. 347, 356 (D. Del. 1977); Broder v. Dane, 384 F. Supp. 1312, 1318-19 (S.D.N.Y. 1974)).*

n313 Where open market repurchases are concerned, even that element of fiduciary principles is absent. The identity of the purchaser is unknown, and presumably irrelevant, to the seller. No fiduciary duty of disclosure has ever been identified in that circumstance, and none should be.

n314 See, for example, *17 C.F.R. sections 240.13e-3* et seq., 240.14d-1 et seq.

n315 See note 313.

n316 See, for example, *Myzel v. Fields, 386 F.2d 718, 733 (8th Cir. 1967); Mansfield, 263 F.2d at 752; Kahn, 591 A.2d at 170-71; Weinberger, 457 A.2d at 712; Lynch, 383 A.2d at 281.* But see *Shell Petroleum, 606 A.2d at 113* (holding that the understatement of discounted future net cash flows from oil and gas reserves was a material omission).

n317 *Harman v. Masoneilan International, Inc., 442 A.2d 487, 497-98 (Del. 1982);* Shepherd, Law of Fiduciaries at 13 (cited in note 49); Finn, Fiduciary Obligations at 1 (cited in note 250).

n318 *Myzel, 386 F.2d at 742; Mansfield, 263 F.2d at 750; Joseph, 482 A.2d at 344-45.*

n319 *Sealy Mattress Co. of New Jersey, Inc. v. Sealy, Inc., 532 A.2d 1324, 1335 (Del. Chanc. 1987).*

n320 *Shell Petroleum, 606 A.2d at 113; Weinberger, 457 A.2d at 701.*

n321 *Myzel, 386 F.2d at 742; Mansfield, 263 F.2d at 750; Lynch, 429 A.2d at 503 n.5.*

n322 *Gaffin v. Teledyne, Inc., 611 A.2d 467, 475 (Del. 1992); Smith v. Shell Petroleum, Inc., 606 A.2d 112 (Del. 1992); Weinberger, 497 A.2d at 792.*

The sums awarded in these fiduciary duty of disclosure cases--$ 1 or $ 2 per share to a class consisting of millions of shares--do not comport with generally accepted definitions of "nominal damages." See, for example, *Carey v. Piphus, 435 U.S. 247, 266 (1978); Guthridge v. Pen-Mod, Inc., 239 A.2d 709, 714 (Del. Super. Ct. 1967)* ("Nominal damages are assessed in some trifling or trivial amount, such as six cents or one dollar . . . ."); *Restatement (Second) of Torts section 907* (1977) ("Nominal damages are a trivial sum of money awarded to a litigant who has established a cause of action but has not established that he is entitled to compensatory damages."); Dan B. Dobbs, Handbook On The Law Of Remedies section 3.8 at 191 (West, 1973) ("Nominal damages, as the term implies, are damages in name only, that is, in trivial sums such as six cents or $ 1 or $ 10.").

n323 *Tri-Star Pictures, 634 A.2d at 333.*

n324 See, for example, *Guth, 5 A.2d at 510;* Scott and Fratcher, 3 Law of Trusts section 205 at 239 (cited in note 49); Bogert and Bogert, Trusts and Trustees section 543(V) (cited in note 108).

n325 See, for example, *8 Del. Code Ann. sections 242* (charter amendments), 251 (mergers), 271 (sales of all or substantially all assets), 275 (dissolution). See also Model Bus. Corp. Act Ann. sections 10.03(b)(1) (charter amendments), 11.03(b)(1) (mergers and share exchanges), 12.02(b)(1) (sales of assets other than in regular course of business), and 14.02(b)(1) (voluntary dissolution).

n326 Federal law requires directors of registered companies to issue a recommendation with respect to a tender offer for the corporation's shares. *17 C.F.R. section 240.14*-e2.

n327 See note 260. In Van Gorkom, the Delaware Supreme Court underscored the importance of the duty of the board of directors, under a corporate merger statute, to make the initial judgment whether to enter into a merger agreement: "Certainly in the merger context, a director may not abdicate that duty by leaving to the shareholders alone the decision to approve or disapprove the agreement." *488 A.2d at 873.*

n328 See DeMott, *1988 Duke L. J. at 908* (cited in note 250) (characterizing the "central preoccupation of fiduciary obligation" as "minimizing potential or incipient conflicts in parties' interests").

n329 Shepherd, Law of Fiduciaries at 245-48 (cited in note 49) ("Where it is proved that one person reasonably relied on the advice or information of another, a fiduciary relationship may arise. . . . Where the advice or information is unsound, and . . . no bias has in fact been proved, the fiduciary may be held liable for the tort of negligent misrepresentation under normal tort principles."). Shepherd's rejection of a fiduciary underpinning of a disinterested disclosure duty stems from his position that the "duty of care has no essential connection with the fiduciary relationship," as it "arises not only in fiduciary situations, but also in contractual and tortious situations." Id. at 48-49, 247.

n330 See text accompanying notes 354-56.

n331 *Van Gorkom, 488 A.2d at 872* ("A director's duty to inform himself in preparation for a decision derives from the fiduciary capacity in which he serves the corporation and its stockholders."); Glinert v. Wickes Cos., *16 Del. J. Corp. L. 764, 780 (1991),* aff'd, *586 A.2d 1201 (Del. 1990)* (stating that the law of fiduciaries subjects managers' conduct "to review when a claim of disloyalty or lack of due attention is made") (emphasis added)); *Francis v. United Jersey Bank, 87 N.J. 15, 432 A.2d 814, 824 (N.J. 1981)* (finding a director in breach of the duty of care, noting that "the relationship of a corporate director to the corporation and its stockholders is that of a fiduciary"); Robert W. Hamilton, Corporations 465 (3d ed. 1992) (identifying the duty of care within "the scope of fiduciary duties owed by directors").

Moreover, trustees owe a duty to exercise care under ordinary trust law. *Restatement (Second) of Trusts section 174* (1959); Bogert and Bogert, Trusts and Trustees section 541 at 167 (cited in note 108); Scott and Fratcher, 2A Law of Trusts section 174 (cited in note 49); Langbein, *105 Yale L. J. at 656* (cited in note 250).

n332 See *Arnold, 650 A.2d at 1286-88.* The relevant Delaware statute permits limitation of liability only for "breach of fiduciary duty as a director." *8 Del. Code Ann. section 102(b)(7)* (emphasis added).

n333 An agent who gives advice to a principal who relies on that advice, at least where the agent possesses superior knowledge, must disclose information material to the principal's decision. *Restatement (Second) of Agency section 381* at 182 (1958). This principle has been found applicable in dealings between real estate brokers and their clients, *Licari v. Blackwelder, 539 A.2d 609, 613 (Conn. App. 1988), Urban Investments Inc. v. Branham, 464 A.2d 93, 96 (D.C. 1983), Hurney v. Locke, 308 N.W.2d 764, 768 (S.D. 1981), Quechee Lakes Rental Corp. v. Boggess, 608 A.2d 39, 41 (Vt. 1992);* securities brokers and their clients, *Merrill Lynch, Pierce, Fenner & Smith v. Perelle, 514 A.2d 552, 560-61 (Pa. Super. Ct. 1986);* and lawyers and their clients, *Grunwald v. Bronkesh, 621 A.2d 459, 464 (N.J. 1993).* See also Shepherd, Law of Fiduciaries at 28-32 (cited in note 49); Finn, Fiduciary Obligations at 50-51 (cited in note 250).

n334 See, for example, *New York Dry Dock v. McCollom, 16 N.Y.S.2d 844, 847 (N.Y. Sup. 1939).* See also note 260.

n335 See text accompanying notes 19-21.

n336 This perspective on corporate information is not at all novel. A particularly clear articulation of the perspective is found in a 1903 opinion of the Georgia Supreme Court identifying a duty on the part of a corporate director and officer to disclose to an outside stockholder a proposed sale of corporate assets prior to acquiring the outsider's stock: "In a certain sense the information is a quasi asset of the company, and the shareholder is as much entitled to the advantage of that sort of an asset as to any other regularly entered on the list of the company's holding." *Oliver v. Oliver, 118 Ga. 362, 45 S.E. 232, 234 (1903).* See also *Childs v. RIC Group, 331 F. Supp. 1078, 1082 (N.D. Ga. 1970);* Shepherd, Law of Fiduciaries at 330-31 (cited in note 49).

The notion that corporate information is to be managed for the benefit of the stockholders underlies judicial approval of the use of internal corporate data as an inducement to potential bidders to accede to auction rules designed to secure the highest reasonably available price in a sale of the company. See, for example, Alliance Gaming Corp. v. Bally Gaming Int'l., Inc., 1995 Del. Chanc. LEXIS 101 (Aug. 11, 1995); *In re J.P. Stevens & Co., Inc. Shareholders Litigation, 542 A.2d 770, 784 (Del. Chanc. 1988);* Confidentiality and Standstill Agreements: Battleground for Control of the Process, Corporate Control Alert (May 1988) (describing Delaware Court of Chancery ruling denying injunction requiring target company to afford access to internal data to a bidder unwilling to sign a standstill agreement, and quoting target company counsel's defense of the company's position as "a plausible method of running the bidding process to maximize shareholder value").

n337 See note 187.

n338 See, for example, *Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).* See also Block, Business Judgment Rule at 11-19 (cited in note 30); S. Samuel Arsht, The Business Judgment Rule Revisited, *8 Hofstra L. Rev. 93, 111-12 (1979);* Dooley, *47 Bus. Law. at 471-72* (cited in note 260).

n339 See notes 19-21 and accompanying text.

n340 See cases cited in notes 18, 167, 241, and 307. See also Mitchell, *43 Duke L. J. at 472-73* (cited in note 99).

n341 See *Anderson Clayton, 519 A.2d at 676-78* (allowing that rejection of a hostile competing offer could "be a rational choice," but enjoining consummation of a management-sponsored recapitalization due to inaccurate characterization, in solicitation of stockholder votes to approve the recapitalization, of management's intentions regarding further exploration of the hostile bid); Oesterle and Palmiter, *79 Iowa L. Rev. at 565* (cited in note 30) ("State judges (principally in Delaware) place themselves in the omnipotent position of the 'reasonable shareholder' to review management disclosure under a common-law fiduciary standard of 'complete candor.' ").

n342 Part I.B.

n343 *519 A.2d at 669.*

n344 *Id. at 675.*

n345 Proof of a likelihood of ultimate success on the merits is traditionally considered a prerequisite to preliminary injunctive relief. See, for example, *Doran v. Salem Inn, Inc., 422 U.S. 922, 931 (1975); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (Del. 1986).*

n346 See note 188.

n347 *SEC v. Chenery Corp., 318 U.S. 80, 85-86 (1943)* (Frankfurter, J.) ("To say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligation does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?").

n348 As stated by the Second Restatement of Torts:

> One who, in the course of his business, profession or employment . . . supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

Restatement (Second) of Torts section 552(1) (1977).

n349 Id. section 552(2).

n350 Id.

n351 Id.

n352 In reviewing this article, Professor Langevoort commented perceptively that a negligent misrepresentation model of the recommendation disclosure duty of directors might afford stockholders a remedy for director inattention not amounting to "gross negligence." This is contrary to established Delaware law requiring proof of "gross negligence" as a predicate to a breach of the fiduciary duty of care. See note 267 and accompanying text. The concern is that a director's failure to take note of a material fact might become actionable because of its nondisclosure to stockholders in connection with recommending a transaction, while that same failure might not be so negligent as to constitute a breach of the duty of care.

This concern may be more troubling in theory than in practice. Despite any superficial variance in the language of the standards of culpability--that is, between the substantive due care test and the negligent misrepresentation model--it seems unlikely that a court would validate a director's decision despite a failure to ascertain a material fact but nevertheless hold that same director personally liable for a failure to disclose that fact in recommending stockholder action. Perhaps the line between ordinary negligence and "gross negligence" is overdrawn. See, for example, Quillen, *10 Del. J. Corp. L. at 500* (cited in note 153) ("In information gathering, a negligence standard without the superlatives may be appropriate so long as courts recognize that 'circumstances' vary. Such a standard would not be materially different in result than the 'gross negligence' standard of Trans Union . . . ."); Arsht, *8 Hofstra L. Rev. at 101-11* (cited in note 338). In any event, there is no intent to suggest here a more stringent rule of director liability for inattention in gathering material information.

n353 See, for example, *Rosenblatt, 493 A.2d at 943;* ALI Principles section 4.01(b) cmt. b at 170-72 (cited in note 32).

n354 Parts V.A and B.

n355 Thus, there is some merit in the suggestion by Professor Solomon that "state regulation of proxy solicitations is a logical outgrowth of state statutes governing notice to shareholders of shareholder meetings." Corporations Law at 841 (cited in note 30). Contrary to one possible reading of Stroud, the existence of a duty of disclosure is dependent upon the fiduciary recommendation, and can exist as Stroud itself suggested, see text accompanying notes 217-19, even in the absence of management solicitation of proxies. Nevertheless, as the Delaware Supreme Court has now made clear, the disclosure duty is that of the directors making the recommendation, and not that of the corporation itself. *Arnold, 678 A.2d at 539.*

n356 *Arnold, 650 A.2d at 1277.*

n357 See *SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968).*

n358 See *Stroud, 606 A.2d at 89* (discussing the need to "balance the board's duty to disclose all available material information in connection with the contemplated shareholder vote against its concomitant duty to protect the corporate enterprise," and holding that a board might permissibly withhold "material confidential information from shareholders, who having been given notice and opportunity, failed to execute a reasonable confidentiality agreement").

n359 Such access may be derived not only from an active management role, but also from exercised contractual rights to information, such as a right under a stockholders' agreement to attend board meetings, consult with officers, or the like.

n360 See Abajian v. Kennedy, *18 Del. J. Corp. L. 179, 191-92 (Del. Chanc. 1992); In re USA Cafes, L.P. Litigation, 600 A.2d 43, 54 (Del. Chanc. 1991)* (dismissing "state law breach of duty of candor claims" because "neither plaintiffs nor any class member could have been injured by the alleged disclosure defect as they had neither a right to vote nor a right to dissent and seek appraisal"); Glinert, *16 Del. J. Corp. L. at 784* ("Warrant holders who have no role in approving a transaction have no right arising from fiduciary duties to demand disclosure, complete or otherwise [relating to that transaction]."). See also *Virginia Bankshares, 501 U.S. at 1099-1108* (holding that where votes of minority stockholders were not necessary to effect a freeze-out merger, the proxy statement was not an "essential link in the accomplishment of the transaction," so no private right of action under section 14(a) of the Securities Exchange Act of 1934, *15 U.S.C. section 78n*(a), was available) (citing *Mills, 396 U.S. at 385 n.7);* Thouret v. Hudner, 1995-1996 Fed. Secur. L. Rptr. (CCH) paragraph 99,037 (S.D.N.Y. Jan. 30, 1996) (holding that there is no private right of action under section 14(a) of the Securities Exchange Act, where minority stockholder votes were "totally unnecessary and irrelevant to the passage of the directors' proposal for the election of directors at the annual shareholders' meeting," and distinguishing cases where "minority shareholders have given up state law remedies, such as appraisal rights, as a result of false and misleading statements contained in a proxy statement"); Christopher Money, Note, Virginia Bankshares v. Sandberg: Should Minority Approval Be Required By Law or Corporate Bylaw?, *37 Ariz. L. Rev. 913, 923-25 (1995).* But see Jesse A. Finkelstein, The Potential Implications of Virginia Bankshares for Delaware Law, in 6 Insights 28 (May 1992) (noting that when a shareholder vote is sought although not required or needed, directors "arguably . . . may be bound to solicit stockholder approval consistent with the standards that would apply had they been required to seek a vote").

Again, it must be observed that under Delaware law the adoption of charter amendments in Stroud did not afford any appraisal remedy to the stockholders, and thus did not present them with any choice of actions in regard to which they could have relied upon the information supplied by the directors in relation to the charter amendment proposals. Where an efficacious choice exists--where there is an appraisal remedy, or where the controlling stockholder group structures the transaction to require the separate approval of a majority of the minority stockholders--the rationale for the recommendation disclosure duty reappears and justifies imposition of the duty. See note 193.

n361 See *17 C.F.R. sections 240.14a-3*, .14e-2.

n362 See notes 279, 316.

n363 See, for example, *Arnold, 650 A.2d at 1270; Zirn, 621 A.2d at 773; Weinberger v. Rio Grande Industries, 519 A.2d at 116.*

n364 *Restatement (Second) of Torts section 551(2)(b)* (1977) provides in relevant part:

One party to a business transaction is under a duty to exercise reasonable care to disclose to the other before the transaction is consummated . . . .

(b) matters known to him that he knows to be necessary to prevent his partial or ambiguous statement from being misleading.

In addition, *Restatement (Second) of Torts section 552(1)* provides:

One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

The fiduciary recommendation disclosure duty simply extends the obligation prescribed in section 551(2)(b) by applying it to directors who are not a party to the business transaction to which their recommendation relates. The "pecuniary interest" element of section 552(1) should be considered applicable to director recommendations of stockholder action. "The fact that the information is given in the course of the defendant's business, profession or employment is a sufficient indication that he has a pecuniary interest in it, even though he receives no consideration for it at the time." Id. section 552 cmt. d.

Although the Restatement's formulation of negligent misrepresentation doctrine literally addresses only a person who "supplies false information," id. section 552(1), the doctrine has been extended to reach misleading omissions of material facts. See *University of Illinois v. First American National Bank of Nashville, 1989 U.S. Dist. LEXIS 9525,* *8-9 (N.D. Ill. Aug. 7, 1989); *Gale v. Value Line, Inc., 640 F. Supp. 967, 971 n.5 (D.R.I. 1986); Amtruck Factors v. International Forest Products, 59 Wash. App. 8, 795 P.2d 742, 747 (1990).* But see *Ames v. Uranus, Inc., 1994 U.S. Dist. LEXIS 12639,* *49 (D. Kan. Aug. 24, 1994) (false statement required); *In re Convergent Technologies Securities Litigation, 721 F. Supp. 1133, 1139 n.4 (N.D. Cal. 1988),* aff'd, *948 F.2d 507 (9th Cir. 1991); Mirkin v. Wasserman, 12 Cal. App. 4th 927, 937 n.11 (Cal. Ct. App. 1991),* aff'd, *858 P.2d 568 (Cal. 1993).*

n365 See note 260.

n366 *Arnold, 650 A.2d at 1286-88.*

n367 Weinrib, *25 U. Toronto L. J. at 20* (cited in note 250).

n368 Frankel, Fiduciary Relationships at 833 (cited in note 250) (citing *Goodwin, 186 N.E. at 659).*

n369 See, for example, *Pollitz v. Wabash R.R. Co., 207 N.Y. 113, 100 N.E. 721, 724 (N.Y. 1912)* (directors' exercise of their powers over "questions of policy and management . . . for the common and general interests of the corporation may not be questioned, although the results show that what they did was unwise or inexpedient"); Block, Business Judgement Rule at 5-11 (cited in note 30) (citing cases).

n370 *488 A.2d at 858.*

n371 Easterbrook and Fischel, Economic Structure at 107 (cited in note 3) (suggesting, in discussing the duty of care aspect of the case, that "if Van Gorkom is a more traditional business judgment case, it is an outlier").

n372 See note 15.

n373 See note 16.

n374 See, for example, *Cinerama, 663 A.2d at 1148* ("The corporate liability rule should certainly be less stringent than that of the trust law.").

n375 *In re New York, New Haven & Hartford R.R. Co., 567 F.2d 166, 179 (2d Cir. 1977)* ("A basic tenet of trust law is that 'ordinarily a trustee does not commit a breach of trust if he does not intentionally or negligently do what he ought not to do or fail to do what he ought to do' . . . . The element of voluntariness is critical.") (citation omitted); *Jennings v. Murdock, 220 Kan. 182, 553 P.2d 846, 871 (Kan. 1976);* Scott and Fratcher, Law of Trusts section 201 at 219 (cited in note 49) (same).

The duty of a trustee to disclose material information to the beneficiary has been discussed in quite a few cases, but in none of those cases has a disinterested trustee been surcharged, or held liable in damages, for a non-negligent failure to make disclosure. See note 188.

n376 It has been suggested that "in Delaware existing law and policy have evolved into a virtual per se rule of damages for breach of the fiduciary duty of disclosure." *Tri-Star, 634 A.2d at 333.* See also *Cinerama, 663 A.2d at 1176.* This suggestion is untenably broad if only because liability in damages for disinterested directors is unjustified in the absence of lack of due care in providing material information to stockholders. It is untenably broad for the additional reason, discussed below, that even upon proof of lack of such care, disinterested director liability in damages depends upon proof of actual loss by the stockholder (or the corporation) seeking to impose such liability. See note 389.

n377 This is the approach taken in several of the Delaware cases in which a breach of the fiduciary disclosure duty by disinterested directors has been identified. Gilmartin, *18 Del. J. Corp. L. at 281; Anderson, Clayton, 519 A.2d at 669; Lacos Land, 517 A.2d at 271.* See also cases cited in note 152. The Delaware Supreme Court's recent opinion in Arnold endorses this approach, noting that stockholders subject to breach of a fiduciary disclosure duty "remain protected by the availablity of injunctive relief," even where money damages cannot be assessed against the breaching directors due to an exculpatory provision in the certificate of incorporation. *Arnold, 678 A.2d at 542.*

n378 See *Edelman, 559 F. Supp. at 1184* (nullifying charter amendment eliminating cumulative voting, due to violations of both federal law (SEC Rule 14a-9, *17 C.F.R. section 240.14a-9*) and director fiduciary duty of disclosure). For cases in which the courts have declined to grant rescission due to intervening events rendering the remedy impracticable, see, for example, Mills v. Electric Auto-Lite Co., 1972 Fed. Secur. L. Rptr. (CCH) paragraph 93,354 (N.D. Ill. Jan. 10, 1972), rev'd on other grounds, *552 F.2d 1239* (7th Cir.); *Lynch, 429 A.2d at 501;* Smith v. Shell Petroleum, 1990 Fed. Secur. L. Rptr. (CCH) paragraph 95,316, at 96,497-98 (Del. Chanc. June 19, 1990).

n379 See Part II.B.

n380 See cases cited in note 90. See also Loudon, 1996 Del. Chanc. LEXIS 12 at *8-11 (refusing to employ the Delaware election review statute (*8 Del. Code Ann. section 225*) to invalidate an election of directors, in the absence of any competing claimants to the directorships at issue, based solely on alleged omissions in proxy solicitation materials).

n381 *Bresnick, 175 F. Supp. at 725; In re Seminole Oil & Gas Corp., 150 A.2d 20, 23 (Del. Chanc. 1959)* ("Where, as here, the conflicting claims and answers were presented to the stockholders at length, I think that is a factor which militates against the ordering of a complete resolicitation."); *Goldfield Corp., 327 N.Y.S.2d at 335.*

n382 Even so, courts have on rare occasions invoked state law disclosure duties to require a new election of directors or other stockholder vote. See, for example, *American Hide, 127 A. at 659; In re Scheuer, 59 N.Y.S.2d at 500; Wyatt, 59 N.Y.S.2d at 502; Lieferant v. Bartell, 232 N.Y.S.2d 1003 (N.Y. Sup. Ct. 1962).*

n383 See *Arnold, 650 A.2d at 1286-88* (construing a charter provision adopted pursuant to *8 Del. Code Ann., section 102(b)(7)*).

n384 This two-part proposition follows from the analogy to principles of negligent misrepresentation, discussed in text accompanying notes 350-52. See, for example, Wolf v. Magness Construction Co., 1995 Del. Chanc. LEXIS 122, *4 (Sep. 11, 1995), aff'd, *676 A.2d 905 (Del. 1996)* (requiring "pecuniary loss caused by justifiable reliance upon the false information"); Glosser v. Cellcor Inc., *20 Del. J. Corp. L. 341, 380-81 (1995)* (citing *Restatement (Second) of Torts section 552* (1977)). With respect to the causation requirement, see also *McNair v. Capital Electric Power Assoc., 324 So.2d 234 (Miss. 1975)* (finding no showing that nondisclosure by trustees affected the vote of nonprofit cooperative members on a merger proposal).

The concepts of reliance and causation in the disinterested recommendation context bear further explanation. They are relatively easy to grasp where the stockholder action alleged to have been harmful is the sale of shares, as in response to a tender offer. In that situation, stockholders who do not sell are in no position to complain that they relied on a nondisclosure by directors in their Schedule 14D-9; only stockholders who do sell can make that claim. Abajian v. Kennedy, *18 Del. J. Corp. L. at 191-92.*

The issues are more complex where reliance is collective, as where all shares are converted in a merger but not all stockholders vote in favor of the merger. In that context, even a stockholder who did not vote in favor of the merger, but whose shares are claimed to be underpaid for in the merger, can claim his harm to have been caused by the disclosure failure, if that failure can be shown to have brought about the necessary vote of the other stockholders. Id. (citing Freedman v. Restaurant Associates Industries, Inc., *16 Del. J. Corp. L. 1462, 1476-77 (1991)).* See also *Edelman, 559 F. Supp. at 1185* (plaintiff stockholder has standing to seek invalidation of charter amendment eliminating right to cumulative voting, even though plaintiff did not vote in favor of the amendment).

n385 *Tri-Star, 634 A.2d at 333.*

n386 Compare *Cede & Co., 634 A.2d at 370-71* ("The tort principles of Barnes [v. *Andrews, 298 F. 614 (S.D.N.Y. 1924)* (Hand, J.)], have no place in a business judgment rule standard of review analysis.") with *Frankel v. Slotkin, 984 F.2d at 1336-37* ("Breach of fiduciary obligation is a tort claim, and thus requires the showing of a duty, a breach, an injury, and causation."); ALI Principles sections 4.01(d), 7.18 (cited in note 32).

n387 See, for example, John Norton Pomeroy, A Treatise on Equity Jurisprudence as Administered in the United States of America section 423 (Bancroft-Whitney, Spencer W. Symons, ed., 5th ed. 1941).

n388 Precisely this plea was made by plaintiff on remand in Arnold v. Society for Savings, 1995 Del. Chanc. LEXIS 86, *4, *25 (June 15, 1995), aff'd, *678 A.2d 533 (Del. 1995).* Acknowledging that "it is often thought to be axiomatic that a wrong must have a correlative remedy," the Delaware Supreme Court recognized that "this is not always the case." *678 A.2d at 541.* The court reasoned that loss of potential remedies, due either to passage of time or stockholder action approving elimination of director monetary liability, cannot force the creation of some unprecedented damages remedy against the corporation itself.

n389 Thus, it is not merely the stockholders' adoption of an exculpatory charter provision that left them without a remedy in Arnold, as the court there suggested. *678 A.2d at 542.* In fact, that suggestion unnecessarily intimates that the stockholders would have had a damages remedy against the disinterested directors of Society for Savings but for the exculpatory provision.

n390 For example, in evaluating issues of standing or the existence of a private right of action under the federal securities laws, the courts have considered the policies of those laws to confer standing upon a tender offeror to seek injunctive relief to cure a disclosure violation, while denying the offeror standing to pursue a claim for damages based upon such a violation. Compare *Piper v. Chris-Craft Industries, Inc., 430 U.S. 1, 42 n.33 (1977)* (denying offeror standing to seek damages in respect of a violation of section 14(e) of the Securities Exchange Act of 1934, *15 U.S.C. section 78n*(e)), with *Mobil Corp. v. Marathon Oil Co., 669 F.2d 366, 371-73 (6th Cir. 1981)* (allowing a tender offeror standing to seek injunctive relief against conduct in violation of section 14(e)).

Similarly, and even more to the present point, federal courts interpreting implied rights of action under the proxy rules have differentiated the culpability requirements for relief, depending upon whether the relief sought is an injunction or damages. See *Ash v. LFE Corp., 525 F.2d 215, 220 (3d Cir. 1975)* ("Whatever may be the rule with respect to scienter where other remedies such as damages or rescission of a sale are sought, we have no hesitancy in recognizing that for prospective relief looking to the protection of the franchise the test for the purposes of Rule 14a-9 is the objective sufficiency of the disclosure."); *Calumet Industries, Inc. v. MacClure, 464 F. Supp. 19, 28 (N.D. Ill. 1978).*

n391 Stock exchange rules require that listed companies publicly disseminate current information of material significance to investors. See, for example, NYSE Listed Company Manual paragraph 202.05, reprinted in 3 Fed. Secur. L. Rptr. (CCH) paragraph 23,519 at 17,214:

A listed company is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for its securities. This is one of the most important and fundamental purposes of the listing agreement which the company enters into with the Exchange.

See also American Stock Exchange Guide section 402(a), reprinted in 3 Fed. Secur. L. Rptr. (CCH) paragraph 23,124A, at 17,098; NASD Manual, By-Laws Schedule D, Part 2, section (c)(15) (CCH) paragraph 1803 at 1566 (1991).

To be sure, there may be occasions on which the directors do intend to influence stockholder action by the content of a press release. Marhart clearly involved a suggestion of such behavior, and as that case shows, dissemination of false information intended to induce existing stockholders, to their detriment, to retain their stock, will support a claim of common law fraud. Marhart, *18 Del. J. Corp. L. at 337.*

n392 See *15 U.S.C. section 78f*(b)(5) (conditioning stock exchange registration upon adoption of exchange rules "designed to . . . perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest . . . "); Brown, Corporate Disclosures section 3.06[1] at 3-64 (cited in note 22).

n393 *Restatement (Second) of Torts sections 526*, 529, 534 & cmt. c, 537, 548 (1977).

n394 In its July 25, 1996 opinion in Kahn v. Roberts, the Delaware Supreme Court declined to adopt the court of chancery's ruling that no such fiduciary disclosure duty exists, and it cautioned that "this court has never stated that full disclosure is required only when seeking shareholder action." *1996 Del. LEXIS 275*, *20 (emphasis in original). The court noted that the "court of chancery has not spoken with a unified voice on this question." Id. at n.7. The court's observation of disunity was correct. The balance of precedent, however, weighs against the creation of a fiduciary disclosure duty universally acceptable to all public corporate disclosures regardless of context, scope of dissemination, or purpose. See *First Eastern Corp. v. Mainwaring, 1992 U.S. Dist. LEXIS 16979*, *20-21 (E.D. Pa. Nov. 4, 1992) (granting partial dismissal, finding no director fiduciary "duty of candor" under Pennsylvania law in respect of allegedly false or misleading statements in periodic reports); Uni-Marts, Inc. v. Stein, 1996 Del. Chanc. LEXIS 95, *21 (Aug. 9, 1996) ("Fiduciary liability for misdisclosure requires that the material misstatement or omission by a fiduciary be in connection with the solicitation of shareholder action, such as tender, a vote, a consent or a withholding of the same."); Kahn v. Roberts, 1995 Del. Chanc. LEXIS 151, *21 (Dec. 6, 1995) ("Delaware law does not require a Board to divulge material developments with respect to the company's business if the board does not seek the vote of the shareholders."), aff'd on other grounds, *1996 Del. LEXIS 275* (July 25, 1996); Bragger v. Budacz, 1994 Del. Chanc. LEXIS 202, *14 (Dec. 7, 1994) (since spin-off information statement "did not seek any shareholder action . . . a fiduciary obligation of full disclosure is not implicated"); Herd v. Major Realty Corp., 1990-1991 Fed. Secur. L. Rptr. (CCH) paragraph 95,772, at 98,718 n.2 (dismissing claims based on press releases and a Form 10K because "the duty of candor requires disclosure of all material facts only in connection with a transaction on which stockholders are asked to vote"). See also Levy v. Stern, 1996 Del. Chanc. LEXIS 25, *1 (Mar. 12, 1996) (noting the inconsistency between Marhart and Kahn, but granting summary judgment to defendants instead based on exculpatory charter provision).

Of the cases cited by the Delaware Supreme Court in Kahn, Marhart is clearly the only direct source of precedent for the establishment of a fiduciary duty of disclosure outside the transaction context. The earlier suggestion of such a duty in In re Rexene Corp. Shareholders Litigation, 1991 Fed. Secur. L. Rptr. (CCH) paragraph 96,010, at 90,059 n.1 (Del. Chanc. May 8, 1991), aff'd, *604 A.2d 416 (Del. 1991),* and the subsequent reiteration of Marhart's holding in *Ciro, Inc. v. Gold, 816 F. Supp. at 266,* were both dictum. An earlier order in Levy v. Stern denied a motion to dismiss a claim of material omissions of adverse information where no stockholder action was sought and plaintiffs sold no shares, but it too relied on Marhart. 1996 Del. Chanc. LEXIS 25 at *3-4. Freedman v. Restaurant Associates Indus., Inc., 1990-1991 Fed. Secur. L. Rptr. (CCH) paragraph 95,617, at 97,882 (Del. Chanc. Sept. 19, 1990, revised Sept. 21, 1990), involved a tender offer by a management group, a circumstance in which fiduciary duties are commonly recognized. See Part III.A. The irrelevance of Kelly v. Bell has already been noted. See notes 69 and 85. In *Kahn v. Roberts, 1994 WL 70118* (Del. Chanc. Feb. 28, 1994), the court denied a motion to dismiss a putative class claim of material omission in a letter to stockholders describing the reasons for a repurchase of stock. That ruling rested on the broad proposition that "directors who decide voluntarily to disclose information to stockholders are subject to the duty of full and frank disclosure of all material facts," and relied solely on Marhart and Kelly. At least in Kahn, the communication at issue was one specifically directed to the stockholders, rather than to the market generally, and could more plausibly engender reliance by the stockholders as a distinct group. In all events, the subsequent opinion in Kahn, granting a defense motion for summary judgment, follows the reasoning of Raskin and Herd. See also *Capital Real Estate Investors Tax Exempt Fund Limited Partnership v. Schwartzberg, 929 F. Supp. 105, 116 (S.D.N.Y. 1996)* (noting, only for purposes of evaluating defendants' propensity to violate the securities laws in the future, that the failure of press releases to disclose general partners' conflict of interest in proposed mergers of limited partnerships "almost certainly violated state fiduciary duties requiring full disclosure," even if the press releases were not deemed to have been a "solicitation" under SEC Rule 14a-1).

n395 See *Arnold, 678 A.2d at 539* (declining to "replicate, by state decisional law, the provisions of section 14 of the 1934 Act," since "such a result would represent a significant change to the existing matrix of duties which governs the relationship among stockholders, directors and corporations"). See also Uni-Marts, 1996 Del. Chanc. LEXIS 95 at *22 (stating that the rule in Marhart "would open state courts under the fiduciary duty rubric to the regulation of all market transactions in an issuer's stock by public shareholders whenever a shareholder traded after a public announcement (or failure to announce?) by a corporate officer. A respect for the evolved roles of state regulation of internal corporate affairs and federal regulation of securities markets counsels against such a radical result"); Roger J. Dennis and Patrick J. Ryan, State Corporate and Federal Securities Law: Dual Regulation in a Federal System, 22 Publius: The J. of Federalism 21 (Winter 1992) (urging continuity of the roles historically played by both state and federal law in regulating corporate governance and disclosure). Indeed, given Marhart's falsity, scienter, reliance, and loss requirements, the only real consequence of its characterizing the disclosure duty as fiduciary in nature is to permit the Delaware state courts to entertain, as assertions of breach of fiduciary duty, claims that would otherwise be brought as Rule 10b-5 claims or common law fraud claims in other courts. See Marhart, *18 Del. J. Corp. L. at 336;* notes 396-97.

n396 *17 C.F.R. section 240.10b-5*. See, for example, *Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).* State securities statutes may also support such a claim. See, for example, *Rosenthal v. Dean Witter Reynolds, Inc., 908 P.2d 1095 (Colo. 1995).*

n397 See Arnold S. Jacobs, 5B Litigation and Practice Under Rule 10b-5 section 62 at 3-304 (Clark Boardman, 2d ed. rev. ed. 1992).

n398 *Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 745-47 (1975).*

n399 Marhart, *18 Del. J. Corp. L. at 335.*

n400 Brown, Corporate Disclosure section 9.04 at 9-29 (cited in note 22).

n401 See, for example, *Washington Bancorporation v. Said, 812 F. Supp. 1256, 1271 (D.D.C. 1993); First Eastern Corp. v. Mainwaring, 1992 U.S. Dist. LEXIS 16979* (E.D. Pa. Nov. 4, 1992); Raskin, 1990-1991 Fed. Secur. L. Rptr. paragraph 95,668; Herd, 1990-1991 Fed. Sec. L. Rep. paragraph 95,772; *Lindner Fund, Inc. v. Waldbaum, Inc., 604 N.Y.S. 2d 32, 624 N.E.2d 160, 161 (N.Y. 1993)* (dismissing a claim that fiduciary duty to stockholders required disclosure of a takeover agreement in principle).

The Committee on Corporate Laws of the Section of Business Law develops, and from time to time proposes changes in the Model Business Corporation Act. The following is the proposed version of Section 8.30, including the official comment for subsection (c).

§ 8.30. STANDARDS OF CONDUCT FOR DIRECTORS

(a) Each member of the board of directors, when discharging the duties of a director, shall act: (1) in good faith, and (2) in a manner the director reasonably believes to be in the best interests of the corporation.

(b) The members of the board of directors or a committee of the board, when becoming informed in connection with their decision-making function or devoting attention to their oversight function, shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances.

(c) In discharging board or committee duties a director shall disclose, or cause to be disclosed, to the other board or committee members information not already known by them but known by the director to be material to the discharge of their decision-making or oversight functions, except that disclosure is not required to the extent that the director reasonably believes that doing so would violate a duty imposed under law, a legally enforceable obligation of confidentiality, or a professional ethics rule.

(d) In discharging board or committee duties a director who does not have knowledge that makes reliance unwarranted is entitled to rely on the performance by any of the persons specified in subsection (f)(1) or subsection (f)(3) to whom the board may have delegated, formally or informally by course of conduct, the authority or duty to perform one or more of the board's functions that are delegable under applicable law.

(e) In discharging board or committee duties a director who does not have knowledge that makes reliance unwarranted is entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in subsection (f).

(f) A director is entitled to rely, in accordance with subsection (d) or (e), on:

(1) one or more officers or employees of the corporation whom the director reasonably believes to be reliable and competent in the functions performed or the information, opinions, reports or statements provided;

(2) legal counsel, public accountants, or other persons retained by the corporation as to matters involving skills or expertise the director reasonably believes are matters (i) within the particular person's professional or expert competence or (ii) as to which the particular person merits confidence; or

(3) a committee of the board of directors of which the director is not a member if the director reasonably believes the committee merits confidence.

CROSS-REFERENCES

Committees of board of directors, see § 8.25.
Conflict of interest, see ch. 8F.
Derivative proceedings, see § § 7.40-7.47.
Duty of board of directors, see § 8.01.
Indemnification, see § § 8.50-8.59.
Meetings of board of directors, see § 8.01.
Officer standards of conduct, see § 8.42.
Officers, see § § 8.40 & 8.41.
Quorum of directors, see § 9.24.
Removal of directors, see § § 8.08 & 8.09.
Standards of liability for directors, see § 8.31.
Unlawful distributions, see § 8.33

OFFICIAL COMMENT

3. SECTION 8.30(c)

A duty to disclose information that a director knows to be material to the oversight or decision-making functions of the board or committee has always been embraced in the standards of conduct set forth in subsections (a) and (b). Subsection (c) makes explicit this existing duty of disclosure among directors. Thus, for example, when a member of the board knows information that the director recognizes is material to a decision by the board to approve financial statements of the corporation, the director is obligated to see to it that such information is provided to the other members of the board. So long as that disclosure is accomplished, the action required of the director can occur through direct statements in meetings of the board, or by any other timely means, including, for example, communicating the information to the chairman of the board or the chairman of a committee, or to the corporation's general counsel, and requesting that the recipient inform the other board or committee members of the disclosed information.

Subsection (c) recognizes that a duty of confidentiality can override a director's obligation to share with other directors information pertaining to a current corporate matter, and that a director is not required to make such disclosure to the extent the director reasonably believes that such a duty of confidentiality prohibits it. In some circumstances, a duty of confidentiality may even prohibit disclosure of the nature or the existence of the duty itself. Ordinarily, however, a director who withholds material information based on a reasonable belief that a duty of confidentiality prohibits disclosure should advise the other directors of the existence and nature of that duty. Under the standards of conduct set forth in section 8.30(a), the director may also be required to take other action in light of the confidentiality restraint. The precise nature of that action must, of necessity, depend on the specific circumstances. Depending on the nature of the material information and of the matter before the board of directors or committee of the board, such action may include abstention or absence from all or a portion of the other directors' deliberation or vote on the matter to which the undisclosed information is material, or even resignation as a director. See Official Comment to section 8.62. Finally, a duty of confidentiality may not form the basis for the limitation on disclosure unless it is entered into and relied upon in good faith.

The required disclosure (as defined in section 8.60(7)) that must be made under section 8.62(a) in connection with a director's conflicting interest transaction, and the exceptions to the required disclosure in that context under section 8.62(b), have elements that parallel the disclosure obligation of directors under section 8.30(c). The demands of section 8.62, however, are more detailed and specific. They apply to just one situation--a director's conflict of interest transaction--while the requirements of section 8.30(c) apply generally to all other decision-making and oversight functions. For example, the specific requirements of section 8.62(a)(1) for a deliberation and vote outside the presence of the conflicted director are not imposed universally for all decision-making matters or for oversight matters that do not involve a decision. To the extent they may be different from the generally applicable provisions of section 8.30(c), the specific provisions of subchapter F control and are exclusive with respect to director conflicting interest transactions.

The Committee on Corporate Laws of the Section of Business Law develops, and from time to time proposes changes in the Model Business Corporation Act. The following is the proposed version of Section 8.62, including the official comment for subsections (a) and (b).

§ 8.62. DIRECTORS' ACTION

(a) Directors' action respecting a director's conflicting interest transaction is effective for purposes of section 8.61(b)(1) if the transaction is authorized by the affirmative vote of a majority (but no fewer than two) of the qualified directors who voted on the transaction, after required disclosure to those qualified directors of information not already known by them, or after modified disclosure in compliance with subsection (b), provided that:

(1) the qualified directors have deliberated and voted outside the presence of and without the participation of the conflicted director; and
(2) where the action is taken by a committee, all members of the committee are qualified directors, and either (i) the committee is composed of all the qualified directors on the board of directors or (ii) the members of the committee are appointed by the affirmative vote of a majority of the qualified directors on the board.

(b) Notwithstanding subsection (a), when a transaction is a director's conflicting interest transaction only because a related person described in clause (v) or clause (vi) of section 8.60(5) is a party to or has a material financial interest in the transaction, the conflicted director is not obligated to make required disclosure to the extent that the director reasonably believes that doing so would violate a duty imposed under law, a legally enforceable obligation of confidentiality, or a professional ethics rule, provided that the conflicted director discloses to the qualified directors voting on the transaction:

(1) all information required to be disclosed that is not so violative,
(2) the existence and nature of the director's conflicting interest, and
(3) the nature of the conflicted director's duty not to disclose the confidential information.

(c) A majority (but no fewer than two) of all the qualified directors on the board of directors, or on the committee, constitutes a quorum for purposes of action that complies with this section.

(d) For purposes of this section, "qualified director" means, with respect to a director's conflicting interest transaction, any director who does not have either:

(1) a conflicting interest respecting the transaction or
(2) a familial, financial, professional, or employment relationship with another director who does have a conflicting interest respecting the transaction, where that relationship would reasonably be expected to influence the first director's judgment in any vote taken on the authorization of the transaction.

(e) Where directors' action under this section does not satisfy a quorum or voting requirement applicable to the authorization of the transaction by reason of the articles of incorporation, the bylaws or a provision of law, independent action to satisfy those authorization requirements must be taken by the board of directors or a committee, in which action directors who are not qualified directors may participate.

§ 8.62 OFFICIAL COMMENT

Section 8.62 provides the procedure for action by the board of directors or by a board committee under subchapter F. In the normal course this section, together with section 8.61(b), will be the key method for addressing directors' conflicting interest transactions. Any discussion of section 8.62 must be conducted in light of the overarching requirements that directors act in good faith and on reasonable inquiry. Director action that does not comply with those requirements, even if otherwise in compliance with section 8.62, will be subject to challenge and not be given effect under section 8.62. See the Official Comment to section 8.61(b).

1. SECTION 8.62(a)

The safe harbor for a transaction in which a director has a conflicting interest is effective under section 8.62 if and only if it is approved by qualified directors (a term that is defined in subsection (d)). Action by the board of directors is effective for purposes of section 8.62 if the transaction is approved by the affirmative vote of a majority (but not less than two) of the qualified directors on the board. Action may also be taken by a duly authorized committee of the board but, for the action to be effective, all members of the committee must be qualified directors and the committee must either be composed of all of the qualified directors on the board or must have been appointed by the affirmative vote of a majority of the qualified directors on the board. This requirement for effective committee action is intended to preclude the appointment as committee members of a favorably inclined minority from among all the qualified directors. Except to the limited extent found in subsection (b), approval by the board or a committee must be preceded by required disclosure followed by deliberation and voting outside the presence and without the participation of the conflicted director. After the qualified directors have had the opportunity to question the conflicted director about the material facts, action complying with subsection (a) may be taken at any time before or after the completion of the transaction becomes a legal obligation. A written record of the qualified directors' deliberation and action is strongly encouraged.

2. SECTION 8.62(b)

Subsection (b) is a special provision designed to accommodate, in a practical way, situations where a director who has a conflicting interest is not able to comply fully with the disclosure requirement of subsection (a) because of an extrinsic duty of confidentiality that such director reasonably believes to exist. The director may, for example, be prohibited from making full disclosure because of legal restrictions that happen to apply to the transaction (*e.g.,* grand jury seal or national security statute) or professional canon (*e.g.,* attorney-client privilege). The most frequent use of subsection (b), however, will likely involve common directors who find themselves in a position of dual fiduciary obligations that clash. If *D* is also a director of *Y Co., D* may have acquired privileged confidential information from one or both directorships relevant to a transaction between *X Co.* and *Y Co.,* that *D* cannot reveal to one without violating a fiduciary duty owed to the other. In such circumstances, subsection (b) enables the conflicting interest to be presented for consideration under subsection (a), and thereby enables *X Co.* (and *Y Co.*) and *D* to secure for the transaction the protection afforded by subchapter F even though *D* cannot, by reason of applicable law, confidentiality strictures or a professional ethics rule, make the full disclosure otherwise required.

To comply with subsection (b), *D* must disclose the conflicting interest and all information required to be disclosed that does not violate the duty not to disclose, as the case may be, to which *D* reasonably believes he or she is subject, inform the qualified directors who are to vote on the transaction of the nature of the duty (*e.g.,* that the duty arises out of an attorney-client privilege or out of a duty as a director of *Y Co.* that prevents *D* from making required disclosure as otherwise mandated by clause (ii) of section 8.60(7)). *D* must then play no personal role in the board's (or committee's) ultimate deliberations or action. The purpose of subsection (b) is to make it clear that the provisions of subchapter F may be employed to "safe harbor" a transaction in circumstances where an interested director cannot, because of enforced fiduciary silence, disclose all the known facts. n1 Of course, if *D* invokes subsection (b) and does not make required disclosure before leaving the boardroom, the qualified directors may decline to act on the transaction out of concern that *D* knows (or may know) something they do not. On the other hand, if *D* is subject to an extrinsic duty of confidentiality but has no knowledge of material facts that should otherwise be disclosed, *D* would normally state just that and subsection (b) would be irrelevant. Having disclosed the existence and nature of the conflicting interest, *D* would thereby comply with section 8.60(7).

n1 A director could, of course, encounter the same problem of mandated silence with regard to any matter that comes before the board; that is, the problem of forced silence can arise in situations other than transactions involving a conflicting interest of a director. It could happen that at the same board meeting of *X Co.* at which *D* invokes § 8.62(b), another director who has absolutely no financial interest in the transaction might conclude that under local law he or she is bound to silence (because of attorney-client privilege, for example) and under general principles of sound director conduct would withdraw from participation in the board's deliberations and action.

While subchapter F explicitly contemplates that subsection (b) will apply to the frequently recurring situation where transacting corporations have common directors (or where a director of one party is an officer of the other), that subsection should not otherwise be read as attempting to address the scope, or mandate the consequences, of various silence-privileges. That is a topic reserved for local law.

Subsection (b) is available to *D* if a transaction is a director's conflicting interest transaction only because a related person described in section 8.60(5)(v) or (vi) is a party to or has a material financial interest in the transaction. Its availability is so limited because in those instances a director owes a fiduciary duty to such a related person. If *D* or a related person of *D* other than a related person described in section 8.60(5)(v) or (vi) is a party to or has a material financial interest in the transaction, D's only options are satisfying the required disclosure obligation on an unrestricted basis, abandoning of the transaction, or accepting the risk of establishing fairness in a court proceeding, under section 8.61(b)(3), if the transaction is challenged.

Whenever an interested director proceeds in the manner provided in subsection (b), the other directors should recognize that the interested director may have information that in usual circumstances *D* would be required to reveal to the qualified directors who are acting on the transaction--information that could well indicate that the transaction would be either favorable or unfavorable for *X Co.*

The Committee on Corporate Laws of the Section of Business Law develops, and from time to time proposes changes in the Model Business Corporation Act. The following is the proposed version of Section 8.70, including the official comment.

8.70. BUSINESS OPPORTUNITIES

(a) A director's taking advantage, directly or indirectly, of a business opportunity may not be the subject of equitable relief, or give rise to an award of damages or other sanctions against the director, in a proceeding by or in the right of the corporation on the ground that such opportunity should have first been offered to the corporation, if before becoming legally obligated respecting the opportunity the director brings it to the attention of the corporation and:

(1) directors' action disclaiming the corporation's interest in the opportunity is taken in compliance with the procedures set forth in section 8.62, as if the decision being made concerned a director's conflicting interest transaction, or

(2) shareholders' action disclaiming the corporation's interest in the opportunity is taken in compliance with the procedures set forth in section 8.63, as if the decision being made concerned a director's conflicting interest transaction; except that, rather than making "required disclosure" as defined in section 8.60, in each case the director shall have made prior disclosure to those acting on behalf of the corporation of all material facts concerning the business opportunity that are then known to the director.

(b) In any proceeding seeking equitable relief or other remedies, based upon an alleged improper taking advantage of a business opportunity by a director, the fact that the director did not employ the procedure described in subsection (a) before taking advantage of the opportunity shall not create an inference that the opportunity should have been first presented to the corporation or alter the burden of proof otherwise applicable to establish that the director breached a duty to the corporation in the circumstances.

OFFICIAL COMMENT

Section 8.70 provides a safe harbor for a director weighing possible involvement with a prospective business opportunity that might constitute a "corporate opportunity." By action of the Board of Directors or shareholders of the corporation under section 8.70, the director can receive a disclaimer of the corporation's interest in the matter before proceeding with such involvement. In the alternative, the corporation may (i) decline to disclaim its interest, (ii) delay a decision respecting granting a disclaimer pending receipt from the director of additional information (or for any other reason), or (iii) attach conditions to the disclaimer it grants under section 8.70(a). The safe harbor granted to the director pertains only to the specific opportunity and does not have broader application, such as to a line of business or a geographic area.

The common law doctrine of "corporate opportunity" has long been recognized as a core part of the director's duty of loyalty. The doctrine stands for the proposition that the corporation has a right prior to that of its director to act on certain business opportunities that come to the attention of the director. In such situations, a director who acts on the opportunity for the benefit of the director or another without having first presented it to the corporation can be held to have "usurped" or "intercepted" a right of the corporation. A defendant director who is found by a court to have violated the duty of loyalty in this regard is subject to damages or an array of equitable remedies, including injunction, disgorgement or the imposition of a constructive trust in favor of the corporation. While the doctrine's concept is easily described, whether it will be found to apply in a given case depends on the facts and circumstances of the particular situation and is thus frequently unpredictable. Ultimately, the doctrine requires the court to balance the corporation's legitimate expectations that its directors will faithfully promote its best interests against the legitimate right of individual directors to pursue their own economic interests in other contexts and venues.

In response to this difficult balancing task, courts have developed several (sometimes overlapping) principles to cabin the doctrine. Although the principles applied have varied from state to state, courts have sought to determine, for example, whether a disputed opportunity presented a business opportunity that was:

--the same as, or similar to, the corporation's current or planned business activities ("line of business" test);
--one that the corporation had already formulated plans or taken steps to acquire for its own use ("expectancy" test);
--developed by the director through the use of the corporation's property, personnel or proprietary information ("appropriation" test); or
--presented to the director with the explicit or implicit expectation that the director would present it to the corporation for its consideration--or--in contrast, one that initially came to the director's attention in the director's individual capacity unrelated to the director's corporate role ("capacity" test).

Finally, in recognition that the corporation need not pursue every business opportunity of which it becomes aware, an opportunity coming within the doctrine's criteria that has been properly presented to and declined by the corporation may then be pursued by the presenting director without breach of the director's duty of loyalty.

The fact intensive nature of the corporate opportunity doctrine resists statutory definition. Instead, subchapter G employs the broader notion of "business opportunity" that encompasses any opportunity, without regard to whether it would come within the judicial definition of a "corporate opportunity" as it may have been developed by courts in a jurisdiction. When properly employed, it provides a safe-harbor mechanism enabling a director to pursue an opportunity for his or her own account or for the benefit of another free of possible challenge claiming conflict with the director's duty of loyalty on the ground that the opportunity should first have been offered to the corporation. Section 8.70 is modeled on the safe-harbor and approval procedures of subchapter F pertaining to directors' conflicting interest transactions with, however, some modifications necessary to accommodate differences in the two topics.

1. SECTION 8.70(a)

Subsection (a) describes the safe harbor available to a director who elects to subject a business opportunity, regardless of whether the opportunity would be classified as a "corporate opportunity," to the disclosure and approval procedures set forth therein. The safe harbor provided is as broad as that provided for a director's conflicting interest transaction in section 8.61: if the director makes required disclosure of the facts specified and the corporation's interest in the opportunity is disclaimed by director action under subsection (a)(1) or shareholder action under subsection (a)(2), the director has foreclosed any claimed breach of the duty of loyalty and may not be subject to equitable relief, damages or other sanctions if the director thereafter takes the opportunity for his or her own account or for the benefit of another person. As a general proposition, disclaimer by director action under subsection (a)(1) must meet all of the requirements provided in section 8.62 with respect to a director's conflicting interest transaction and disclaimer by shareholder action under subsection (a)(2) must likewise comply with all of the requirements for shareholder action under section 8.63. Note, however, two important differences.

In contrast to director or shareholder action under sections 8.62 and 8.63, which may be taken at any time, section 8.70(a) requires that the director must present the opportunity and secure director or shareholder action disclaiming it *before* acting on the opportunity. The safe-harbor concept contemplates that the corporation's decision maker will have full freedom of action in deciding whether the corporation should take over a proferred opportunity or elect to disclaim the corporation's interest in it. If the interested director could seek ratification after acting on the opportunity, the option of taking over the opportunity would, in most cases, in reality be foreclosed and the corporation's decision maker would be limited to denying ratification or blessing the interested director's past conduct with a disclaimer. In sum, the safe harbor's benefit is available only when the corporation can entertain the opportunity in a fully objective way.

The second difference also involves procedure. Instead of employing section 8.60(7)'s definition of "required disclosure" that is incorporated in sections 8.62 and 8.63, section 8.70(a) requires the alternative disclosure to those acting for the corporation of "all material facts concerning the business opportunity that are then known to the director." As a technical matter, section 8.60(7) calls for, in part, disclosure of "the existence and nature of the director's conflicting interest"--that information is not only non-existent but irrelevant for purposes of subsection (a). But there is another consideration justifying replacement of the section 8.60(7) definition. In the case of the director's conflicting interest transaction, the director proposing to enter into a transaction with the corporation has presumably completed due diligence and made an informed judgment respecting the matter; accordingly, that interested director is in a position to disclose "all facts known to the director respecting the subject matter of the transaction that a director free of such conflicting interest would reasonably believe to be material in deciding whether to proceed with the transaction." The interested director, placing himself or herself in the independent director's position, should be able to deal comfortably with the objective materiality standard. In contrast, the director proffering a business opportunity will often not have undertaken due diligence and made an informed judgment to pursue the opportunity following a corporate disclaimer. Thus, the disclosure obligation of subsection (a) requires only that the director reveal all material facts concerning the business opportunity that, at the time when disclosure is made, are known to the director. The safe-harbor procedure shields the director even if a material fact regarding the business opportunity is not disclosed, so long as the proffering director had no knowledge of such fact. In sum, the disclosure requirement for subsection (a) must be and should be different from that called for by subchapter F's provisions.

2. SECTION 8.70(b)

Subsection (b) reflects a fundamental difference between the coverage of subchapters F and G. Because subchapter F provides an exclusive definition of "director's conflicting interest transaction," any transaction meeting the definition that is not approved in accordance with the provisions of subchapter F is not entitled to its safe harbor. Unless the interested director can, upon challenge, establish the transaction's fairness, the director's conduct is presumptively actionable and subject to the full range of remedies that might otherwise be awarded by a court. In contrast, the concept of "business opportunity" under section 8.70 is not defined but is intended to be broader than what might be regarded as an actionable "corporate opportunity." This approach recognizes that, given the vagueness of the corporate opportunity doctrine, a director might be inclined to seek safe-harbor protection under section 8.70 before pursuing an opportunity that might or might not at a later point be subject to challenge as a "corporate opportunity." By the same token, a director might conclude that a business opportunity is not a "corporate opportunity" under applicable law and choose to pursue it without seeking a disclaimer by the corporation under section 8.70. Accordingly, subsection (b) provides that a director's decision not to employ the procedures of section 8.70(a) neither creates a negative inference nor alters the burden of proof in any subsequent proceeding seeking damages or equitable relief based upon an alleged improper taking of a "corporate opportunity."

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MODEL BUSINESS CORPORATION ACT (1984)
(Incorporating changes through October 1999)
CHAPTER 7. SHAREHOLDER
Subchapter A. Meetings

1984 Model Business Corporation Act § 7.04

§ 7.04. Action Without Meeting.

(a) Action required or permitted by this Act to be taken at a shareholders' meeting may be taken without a meeting if the action is taken by all the shareholders entitled to vote on the action. The action must be evidenced by one or more written consents bearing the date of signature and describing the action taken, signed by all the shareholders entitled to vote on the action, and delivered to the corporation for inclusion in the minutes or filing with the corporate records.

(b) If not otherwise fixed under sections 7.03 or 7.07, the record date for determining shareholders entitled to take action without a meeting is the date the first shareholder signs the consent under subsection (a). No written consent shall be effective to take the corporation action referred to therein unless, within 60 days of the earliest date appearing on a consent delivered to the corporation in the manner required by this section, written consents signed by all shareholders entitled to vote on the action are received by the corporation. A written consent may be revoked by a writing to that effect received by the corporation prior to the receipt by the corporation of unrevoked written consents sufficient in number to take corporate action.

(c) A consent signed under this section has the effect of a meeting vote and may be described as such in any document.

(d) If this Act requires that notice of proposed action be given to nonvoting shareholders and the action is to be taken by unanimous consent of the voting shareholders, the corporation must give its nonvoting shareholders written notice of the proposed action at least 10 days before the action is taken. The notice must contain or be accompanied by the same material that, under this Act, would have been required to be sent to nonvoting shareholders in a notice of meeting at which the proposed action would have been submitted to the shareholders for action.

OFFICIAL COMMENT TO SECTION 7.04

3. CONSENT TO FUNDAMENTAL CORPORATE CHANGES

Section 7.04 is applicable to all shareholder actions, including the approval of fundamental corporate changes described in chapters 10, 11, 12, and 14. If these actions were taken at an annual or special meeting, shareholders who were not entitled to vote on the matter would nevertheless be entitled to receive notice of the meeting, including a description of the transaction proposed to be considered at the meeting. See, e.g., sections 10.03 (notice of proposed amendment), 11.04 (notice of proposed merger). In order to ensure that nonvoting shareholders have essentially the same right if action is taken by consent rather than at a meeting, section 7.04(d) provides that all nonvoting shareholders must be given at least 10 days' written notice of the fundamental corporate changes that are proposed for approval by consent.

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MODEL BUSINESS CORPORATION ACT (1984)
(Incorporating changes through October 1999)
CHAPTER 7. SHAREHOLDER
Subchapter A. Meetings

1984 Model Business Corporation Act § 7.05

§ 7.05. Notice of Meeting.

(a) A corporation shall notify shareholders of the date, time, and place of each annual and special shareholders' meeting no fewer than 10 nor more than 60 days before the meeting date. Unless this Act or the articles of incorporation require otherwise, the corporation is required to give notice only to shareholders entitled to vote at the meeting.

(b) Unless this Act or the articles of incorporation require otherwise, notice of an annual meeting need not include a description of the purpose or purposes for which the meeting is called.

(c) Notice of a special meeting must include a description of the purpose or purposes for which the meeting is called.

(d) If not otherwise fixed under section 7.03 or 7.07, the record date for determining shareholders entitled to notice of and to vote at an annual or special shareholders' meeting is the day before the first notice is delivered to shareholders.

(e) Unless the bylaws require otherwise, if an annual or special shareholders' meeting is adjourned to a different date, time, or place, notice need not be given of the new date, time, or place if the new date, time, or place is announced at the meeting before adjournment. If a new record date for the adjourned meeting is or must be fixed under section 7.07, however, notice of the adjourned meeting must be given under this section to persons who are shareholders as of the new record date.

OFFICIAL COMMENT TO SECTION 7.05

2. STATEMENT OF MATTERS TO BE CONSIDERED AT AN ANNUAL MEETING

Notice of all special meetings must include a description of the purpose or purposes for which the meeting is called and the matters acted upon at the meeting are limited to those within the notice of meeting. By contrast, the Model Act does not require that the notice of an annual meeting refer to any specific purpose or purposes, and any matter appropriate for shareholder action may be considered. As recognized in subsection (b), however, other provisions of the Model Act provide that certain types of fundamental corporate changes may be considered at an annual meeting only if specific reference to the proposed action appears in the notice of meeting. See sections 10.03, 11.04, 12.02, and 14.02. In addition, as a condition to relying upon shareholder action to establish the safe harbor protection of section 8.61(b), section 8.63 requires notice to shareholders providing information regarding any director's conflict of interest in a transaction. If the board of directors chooses, a notice of an annual meeting may contain references to purposes or proposals not required by statute. In the event that management intends to present non-routine proposals for a shareholder vote and shareholders have not otherwise been informed of such proposals, good corporate practice suggests that references to such proposals be made in the notice. In any event, if a notice of an annual meeting refers specifically to one or more purposes, the meeting is not limited to those purposes.

1984 Model Business Corporation Act § 8.60

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MODEL BUSINESS CORPORATION ACT (1984)
(Incorporating changes through October 1999)
CHAPTER 8. DIRECTORS AND OFFICER
Subchapter F. Directors' Conflicting Interest Transactions

1984 Model Business Corporation Act § 8.60

§ 8.60. Subchapter Definitions.

In this subchapter:

(1) Conflicting interest with respect to a corporation means the interest a director of the corporation has respecting a transaction effected or proposed to be effected by the corporation (or by a subsidiary of the corporation or any other entity in which the corporation has a controlling interest) if

(i) whether or not the transaction is brought before the board of directors of the corporation for action, the director knows at the time of commitment that he or a related person is a party to the transaction or has a beneficial financial interest in or so closely linked to the transaction and of such financial significance to the director or a related person that the interest would reasonably be expected to exert an influence on the director's judgment if he were called upon to vote on the transaction; or

(ii) the transaction is brought (or is of such character and significance to the corporation that it would in the normal course be brought) before the board of directors of the corporation for action, and the director knows at the time of commitment that any of the following persons is either a party to the transaction or has a beneficial financial interest in or so closely linked to the transaction and of such financial significance to the person that the interest would reasonably be expected to exert an influence on the director's judgment if he were called upon to vote on the transaction: (A) an entity (other than the corporation) of which the director is a director, general partner, agent, or employee; (B) a person that controls one or more of the entities specified in subclause (A) or an entity that is controlled by, or is under common control with, one or more of the entities specified in subclause (A); or (C) an individual who is a general partner, principal, or employer of the director.

(2) Director's conflicting interest transaction with respect to a corporation means a transaction effected or proposed to be effected by the corporation (or by a subsidiary of the corporation or any other entity in which the corporation has a controlling interest) respecting which a director of the corporation has a conflicting interest.

(3) Related person of a director means (i) the spouse (or a parent or sibling thereof) of the director, or a child, grandchild, sibling, parent (or spouse of any thereof) of the director, or an individual having the same home as the director, or a trust or estate of which an individual specified in this clause (i) is a substantial beneficiary; or (ii) a trust, estate, incompetent, conservatee, or minor of which the director is a fiduciary.

(4) Required disclosure means disclosure by the director who has a conflicting interest of (i) the existence and nature of his conflicting interest, and (ii) all facts known to him respecting the subject matter of the transaction that an ordinarily prudent person would reasonably believe to be material to a judgment about whether or not to proceed with the transaction.

(5) Time of commitment respecting a transaction means the time when the transaction is consummated or, if made pursuant to contract, the time when the corporation (or its subsidiary or the entity in which it has a controlling interest) becomes contractually obligated so that its unilateral withdrawal from the transaction would entail significant loss, liability, or other damage.

OFFICIAL COMMENT
4. REQUIRED DISCLOSURE

Two separate elements make up the defined term "required disclosure." They are disclosure of the existence of the conflicting interest and then disclosure of the material facts known to D about the subject of the transaction.

Subdivision (4) calls for disclosure of all facts known to D about the subject of the transaction that an ordinarily prudent person would reasonably believe to be material to a judgment by the person acting for the corporation as to whether to proceed or not to proceed with the transaction. If a director knows that the land the corporation is buying from him is sinking into an abandoned coal mine, he must disclose not only that he is the owner and that he has an interest in the transaction but also that the land is subsiding; as a director of X Co. he may not invoke caveat emptor. But in the same circumstances the director is not under an obligation to reveal the price he paid for the property ten years ago, or that he inherited it, since that information is not material to the corporation's business judgment as to whether or not to proceed with the transaction. Further, while material facts that pertain to the subject of the transaction must be disclosed, a director is not required to reveal personal or subjective information that bears upon his negotiating position (such as, for example, his urgent need for cash, or the lowest price he would be willing to accept). This is true despite the fact that such information would obviously be relevant to the corporation's decision-making in the sense that, if known to the corporation, it could equip the corporation to hold out for terms more favorable to it.

Underlying the definition of the twin components of "required disclosure" is the critically important provision contained in subdivision (1) that a basic precondition for the existence of a "conflicting interest" is that the director know of the transaction and also that he know of the existence of his conflicting interest.

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MODEL BUSINESS CORPORATION ACT (1984)
(Incorporating changes through October 1999)
CHAPTER 8. DIRECTORS AND OFFICER
Subchapter F. Directors' Conflicting Interest Transactions

1984 Model Business Corporation Act § 8.63

§ 8.63. Shareholders' Action.

(a) Shareholders' action respecting a transaction is effective for purposes of section 8.61(b)(2) if a majority of the votes entitled to be cast by the holders of all qualified shares were cast in favor of the transaction after (1) notice to shareholders describing the director's conflicting interest transaction, (2) provision of the information referred to in subsection (d), and (3) required disclosure to the shareholders who voted on the transaction (to the extent the information was not known by them).

(b) For purposes of this section, qualified shares means any shares entitled to vote with respect to the director's conflicting interest transaction except shares that, to the knowledge, before the vote, of the secretary (or other officer or agent of the corporation authorized to tabulate votes), are beneficially owned (or the voting of which is controlled) by a director who has a conflicting interest respecting the transaction or a related person of the director, or both.

(c) A majority of the votes entitled to be cast by the holders of all qualified shares constitutes a quorum for purposes of action that complies with this section. Subject to the provisions of subsections (d) and (e), shareholders' action that otherwise complies with this section is not affected by the presence of holders, or the voting, of shares that are not qualified shares.

(d) For purposes of compliance with subsection (a), a director who has a conflicting interest respecting the transaction shall, before the shareholders' vote, inform the secretary (or other officer or agent of the corporation authorized to tabulate votes) of the number, and the identity of persons holding or controlling the vote, of all shares that the director knows are beneficially owned (or the voting of which is controlled) by the director or by a related person of the director, or both.

(e) If a shareholders' vote does not comply with subsection (a) solely because of a failure of a director to comply with subsection (d), and if the director establishes that his failure did not determine and was not intended by him to influence the outcome of the vote, the court may, with or without further proceedings respecting section 8.61(b)(3), take such action respecting the transaction and the director, and give such effect, if any, to the shareholders' vote, as it considers appropriate in the circumstances.

OFFICIAL COMMENT
4. SECTION 8.63(d)

In most circumstances, the secretary of X Co. will have no way to know whether certain of X Co.'s outstanding shares should be excluded from the teller's count because of the identity of the owners or of those persons who control the voting of the shares. Subsection (a) together with subsection (d) therefore impose on a director who has a conflicting interest respecting the transaction, as a prerequisite to safe harbor protection by shareholder vote, the obligation to inform the secretary, or other officer or agent authorized to tabulate votes, of the number and holders of shares known by him to be owned by him or by a related person of his. Thus, a director who has a conflicting interest respecting the transaction, because he stands to make a commission from it, is obligated to report shares owned or the vote of which is controlled by him and by all related persons of his; a director who has a conflicting interest respecting the transaction because his brother stands to make a commission from it has the same reporting obligation. The tabulator may also, of course, have other independent knowledge of shares that are owned or controlled by a related person of the director.

If the tabulator of votes knows that particular shares should be excluded but fails to exclude them from the count and their inclusion in the vote does not affect its outcome, subsection (c) governs and the shareholders' vote stands. If the improper inclusion determines the outcome, the shareholders' vote fails to comply with subsection (a). If the tabulator does not know that certain shares are owned or controlled by the director who has the conflicting interest or a related person of his, the shares are "qualified" pursuant to the definition in subsection (b), and the vote cannot be attacked on that ground for failure to comply with subsection (a); but see subsection (e).

1984 Model Business Corporation Act § 10.03

§ 10.03. Amendment by Board of Directors and Shareholders.

If a corporation has issued shares, an amendment to the articles of incorporation shall be adopted in the following manner:

(a) The proposed amendment must be adopted by the board of directors.

(b) Except as provided in sections 10.05, 10.07, and 10.08, after adopting the proposed amendment the board of directors must submit the amendment to the shareholders for their approval. The board of directors must also transmit to the shareholders a recommendation that the shareholders approve the amendment, unless the board of directors makes a determination that because of conflicts of interest or other special circumstances it should not make such a recommendation, in which case the board of directors must transmit to the shareholders the basis for that determination.

(c) The board of directors may condition its submission of the amendment to the shareholders on any basis.

(d) If the amendment is required to be approved by the shareholders, and the approval is to be given at a meeting, the corporation must notify each shareholder, whether or not entitled to vote, of the meeting of shareholders at which the amendment is to be submitted for approval. The notice must state that the purpose, or one of the purposes, of the meeting is to consider the amendment and must contain or be accompanied by a copy of the amendment.

(e) Unless the articles of incorporation, or the board of directors acting pursuant to subsection (c), requires a greater vote or a greater number of shares to be present, approval of the amendment requires the approval of the shareholders at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast on the amendment exists, and, if any class or series of shares is entitled to vote as a separate group on the amendment, except as provided in section 10.04(c), the approval of each such separate voting group at a meeting at which a quorum of the voting group consisting of at least a majority of the votes entitled to be cast on the amendment by that voting group exists.

OFFICIAL COMMENT TO SECTION 10.03

2. SUBMISSION TO THE SHAREHOLDERS

Section 10.03 requires the board of directors, after having adopted an amendment, to submit the amendment to the shareholders for approval except as otherwise provided by sections 10.05, 10.07, and 10.08. When submitting the amendment, the board of directors must make a recommendation to the shareholders that the amendment be approved, unless the board of directors makes a determination that because of conflicts of interest or other special circumstances it should make no recommendation. For example, the board of directors may make such a determination where there is not a sufficient number of directors free of a conflicting interest to approve the amendment or because the board of directors is evenly divided as to the merits of an amendment but is able to agree that shareholders should be permitted to consider the amendment. If the board of directors makes such a determination, it must describe the conflict of interest or special circumstances, and communicate the basis for the determination, when submitting the amendment to the shareholders. The exception for conflicts of interest or other special circumstances is intended to be sparingly available. Generally, shareholders should not be asked to act on an amendment in the absence of a recommendation by the board of directors. The exception is not intended to relieve the board of directors of its duty to consider carefully the amendment and the interests of shareholders.

Section 10.03(c) permits the board of directors to condition its submission of an amendment on any basis. Among the conditions that a board might impose are that the amendment will not be deemed approved (i) unless it is approved by a specified vote of the shareholders, or by one or more specified classes or series of shares, voting as a separate voting group, or by a specified percentage of disinterested shareholders, or (ii) if shareholders holding more than a specified fraction of outstanding shares assert appraisal rights. The board of directors is not limited to conditions of these types.

*** THIS DOCUMENT IS CURRENT THROUGH THE 2003 EDITION ***

MODEL BUSINESS CORPORATION ACT (1984)
(Incorporating changes through October 1999)
CHAPTER 11. MERGERS AND SHARE EXCHANGES

1984 Model Business Corporation Act § 11.04

§ 11.04. Action on a Plan of Merger or Share Exchange.

In the case of a domestic corporation that is a party to a merger or share exchange:

(a) The plan of merger or share exchange must be adopted by the board of directors.

(b) Except as provided in subsection (g) and in section 11.05, after adopting the plan of merger or share exchange the board of directors must submit the plan to the shareholders for their approval. The board of directors must also transmit to the shareholders a recommendation that the shareholders approve the plan, unless the board of directors makes a determination that because of conflicts of interest or other special circumstances it should not make such a recommendation, in which case the board of directors must transmit to the shareholders the basis for that determination.

(c) The board of directors may condition its submission of the plan of merger or share exchange to the shareholders on any basis.

(d) If the plan of merger or share exchange is required to be approved by the shareholders, and if the approval is to be given at a meeting, the corporation must notify each shareholder, whether or not entitled to vote, of the meeting of shareholders at which the plan is to be submitted for approval. The notice must state that the purpose, or one of the purposes, of the meeting is to consider the plan and must contain or be accompanied by a copy or summary of the plan. If the corporation is to be merged into an existing corporation or other entity, the notice shall also include or be accompanied by a copy or summary of the articles of incorporation or organizational documents of that corporation or other entity. If the corporation is to be merged into a corporation or other entity that is to be created pursuant to the merger, the notice shall include or be accompanied by a copy or a summary of the articles of incorporation or organizational documents of the new corporation or other entity.

(e) Unless the articles of incorporation, or the board of directors acting pursuant to subsection (c), requires a greater vote or a greater number of votes to be present, approval of the plan of merger or share exchange requires the approval of the shareholders at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast on the plan exists, and, if any class or series of shares is entitled to vote as a separate group on the plan of merger or share exchange, the approval of each such separate voting group at a meeting at which a quorum of the voting group consisting of at least a majority of the votes entitled to be cast on the merger or share exchange by that voting group is present.

(f) Separate voting by voting groups is required:

(1) on a plan of merger, by each class or series of shares that (A) are to be converted, pursuant to the provisions of the plan of merger, into shares or other securities, interests, obligations, rights to acquire shares or other securities, cash, other property, or any combination of the foregoing, or (B) would have a right to vote as a separate group on a provision in the plan that, if contained in a proposed amendment to articles of incorporation, would require action by separate voting groups under section 10.04;

(2) on a plan of share exchange, by each class or series of shares included in the exchange, with each class or series constituting a separate voting group; and

(3) on a plan of merger or share exchange, if the voting group is entitled under the articles of incorporation to vote as a voting group to approve a plan of merger or share exchange.

(g) Unless the articles of incorporation otherwise provide, approval by the corporation's shareholders of a plan of merger or share exchange is not required if:

(1) the corporation will survive the merger or is the acquiring corporation in a share exchange;

(2) except for amendments permitted by section 10.05, its articles of incorporation will not be changed;

(3) each shareholder of the corporation whose shares were outstanding immediately before the effective date of the merger or share exchange will hold the same number of shares, with identical preferences, limitations, and relative rights, immediately after the effective date of change; and

(4) the issuance in the merger or share exchange of shares or other securities convertible into or rights exercisable for shares does not require a vote under section 6.21(f).

(h) If as a result of a merger or share exchange one or more shareholders of a domestic corporation would become subject to personal liability for the obligations or liabilities of any other person or entity, approval of the plan of merger shall require the execution, by each such shareholder, of a separate written consent to become subject to such personal liability.

OFFICIAL COMMENT TO SECTION 11.04

2. SUBMISSION TO THE SHAREHOLDERS

Section 11.04(b) requires the board of directors, after having adopted the plan of merger or share exchange, to submit the plan of merger or share exchange to the shareholders for approval, except as provided in subsection (g) and section 11.05. When submitting the plan of merger or share exchange the board of directors must make a recommendation to the shareholders that the plan be approved, unless the board of directors makes a determination that because of conflicts of interest or other special circumstances it should make no recommendation. For example, the board or directors may make such a determination where there is not a sufficient number of directors free of a conflicting interest to approve the transaction or because the board of directors is evenly divided as to the merits of a transaction but is able to agree that shareholders should be permitted to consider the transaction. If the board of directors makes such a determination, it must describe the conflict of interest or special circumstances, and communicate the basis for the determination, when submitting the plan of merger or share exchange to the shareholders. The exception for conflicts of interest or other special circumstances is intended to be sparingly available. Generally, shareholders should not be asked to act on a merger or share exchange in the absence of a recommendation by the board of directors. The exception is not intended to relieve the board of directors of its duty to consider carefully the proposed transaction and the interests of shareholders.

Section 11.04(c) permits the board of directors to condition its submission of a plan of merger or share exchange on any basis. Among the conditions that a board might impose are that the plan will not be deemed approved (i) unless it is approved by a specified vote of the shareholders, or by one or more specified classes or series of shares, voting as a separate voting group, or by a specified percentage of disinterested shareholders or (ii) if shareholders holding more than a specified fraction of the outstanding shares assert appraisal rights. The board of directors is not limited to conditions of these types.

Section 11.04(d) provides that if the plan of merger or share exchange is required to be approved by the shareholders, and if the approval is to be given at a meeting, the corporation must notify each shareholder, whether or not entitled to vote, of the meeting of shareholders at which the plan is to be submitted. Requirements concerning the timing and content of a notice of meeting are set out in section 7.05. Section 11.04(d) does not itself require that notice be given to nonvoting shareholders where the merger is approved, without a meeting, by unanimous consent. However, that requirement is imposed by section 7.04(d).

*** THIS DOCUMENT IS CURRENT THROUGH THE 2003 EDITION ***

MODEL BUSINESS CORPORATION ACT (1984)
(Incorporating changes through October 1999)
CHAPTER 12. DISPOSITION OF ASSETS

1984 Model Business Corporation Act § 12.02

§ 12.02. Shareholder Approval of Certain Dispositions.

(a) A sale, lease, exchange, or other disposition of assets, other than a disposition described in section 12.01, requires approval of the corporation's shareholders if the disposition would leave the corporation without a significant continuing business activity. If a corporation retains a business activity that represented at least 25 percent of total assets at the end of the most recently completed fiscal year, and 25 percent of either income from continuing operations before taxes or revenues from continuing operations for that fiscal year, in each case of the corporation and its subsidiaries on a consolidated basis, the corporation will conclusively be deemed to have retained a significant continuing business activity.

(b) A disposition that requires approval of the shareholders under subsection (a) shall be initiated by a resolution by the board of directors authorizing the disposition. After adoption of such a resolution, the board of directors shall submit the proposed disposition to the shareholders for their approval. The board of directors shall also transmit to the shareholders a recommendation that the shareholders approve the proposed disposition, unless the board of directors makes a determination that because of conflicts of interest or other special circumstances it should not make such a recommendation, in which case the board of directors shall transmit to the shareholders the basis for that determination.

(c) The board of directors may condition its submission of a disposition to the shareholders under subsection (b) on any basis.

(d) If a disposition is required to be approved by the shareholders under subsection (a), and if the approval is to be given at a meeting, the corporation shall notify each shareholder, whether or not entitled to vote, of the meeting of shareholders at which the disposition is to be submitted for approval. The notice shall state that the purpose, or one of the purposes, of the meeting is to consider the disposition and shall contain a description of the disposition, including the terms and conditions thereof and the consideration to be received by the corporation.

(e) Unless the articles of incorporation or the board of directors acting pursuant to subsection (c) requires a greater vote, or a greater number of votes to be present, the approval of a disposition by the shareholders shall require the approval of the shareholders at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast on the disposition exists.

(f) After a disposition has been approved by the shareholders under subsection (b), and at any time before the disposition has been consummated, it may be abandoned by the corporation without action by the shareholders, subject to any contractual rights of other parties to the disposition.

(g) A disposition of assets in the course of dissolution under chapter 14 is not governed by this section.

(h) The assets of a direct or indirect consolidated subsidiary shall be deemed the assets of the parent corporation for the purposes of this section.

OFFICIAL COMMENT TO SECTION 12.02

2. SUBMISSION TO SHAREHOLDERS

Section 12.02(b) requires the board of directors, after having adopted a resolution authorizing a disposition that requires shareholder approval, to submit the disposition to the shareholders for approval. When submitting the disposition to the shareholders, the board of directors must make a recommendation to the shareholders that the disposition be approved, unless the board makes a determination that because of conflicts of interests or other special circumstances it should make no recommendation. For example, the board of directors may make such a determination where there is not a sufficient number of directors free of a conflicting interest to approve the transaction or because the board of directors is evenly divided as to the merits of a transaction but is able to agree that shareholders should be permitted to consider the transaction. If the board of directors makes such a determination, it must describe the conflicts of interests or special circumstances, and communicate the basis for the determination, when submitting the disposition to the shareholders. The exception for conflicts of interest or other special circumstances is intended to be sparingly available. Generally, shareholders should not be asked to act on a disposition in the absence of a recommendation by the board of directors. The exception is not intended to relieve the board of directors of its duty to consider carefully the proposed transaction and the interests of shareholders.

Section 12.02(c) permits the board of directors to condition its submission of a proposed disposition to the shareholders. Among the conditions that board might impose are that the disposition will not be deemed approved: (i) unless it is approved by a specified percentage of the shareholders, or by one or more specified classes or series of shares, voting as a separate voting group, or by a specified percentage of disinterested shareholders, or (ii) if shareholders holding more than a specified fraction of the outstanding shares assert appraisal rights. The board of directors is not limited to conditions of these types.

*** THIS DOCUMENT IS CURRENT THROUGH THE 2003 EDITION ***

MODEL BUSINESS CORPORATION ACT (1984)
(Incorporating changes through October 1999)
CHAPTER 13. APPRAISAL RIGHTS
Subchapter B. Procedure for Exercise of Appraisal Rights

1984 Model Business Corporation Act § 13.20

§ 13.20. Notice of Appraisal Rights.

(a) If proposed corporate action described in section 13.02(a) is to be submitted to a vote at a shareholders' meeting, the meeting notice must state that the corporation has concluded that shareholders are, are not or may be entitled to assert appraisal rights under this chapter. If the corporation concludes that appraisal rights are or may be available, a copy of this chapter must accompany the meeting notice sent to those record shareholders entitled to exercise appraisal rights.

(b) In a merger pursuant to section 11.05, the parent corporation must notify in writing all record shareholders of the subsidiary who are entitled to assert appraisal rights that the corporate action became effective. Such notice must be sent within ten days after the corporate action became effective and include the materials described in section 13.22.

OFFICIAL COMMENT TO SECTION 13.20

Before a vote is taken on a corporate action, the corporation is required by section 13.20(a) to notify record shareholders that a transaction is proposed and that the corporation has concluded either that appraisal rights are or are not available; alternatively, if the corporation is unsure about the availability of appraisal rights, it may state that appraisal rights may be available. Notice of appraisal rights is needed because many shareholders do not know what appraisal rights they may have or how to assert them. If the corporation has concluded appraisal rights are or may be available, the notice must be accompanied by a copy of this chapter.

§ 13.22. Appraisal Notice and Form.

(a) If proposed corporate action requiring appraisal rights under section 13.02(a) becomes effective, the corporation must deliver a written appraisal notice and form required by subsection (b)(1) to all shareholders who satisfied the requirements of section 13.21. In the case of a merger under section 11.05, the parent must deliver a written appraisal notice and form to all record shareholders who may be entitled to assert appraisal rights.

(b) The appraisal notice must be sent no earlier than the date the corporate action became effective and no later than ten days after such date and must:

(1) supply a form that specifies the date of the first announcement to shareholders of the principal terms of the proposed corporate action and requires the shareholder asserting appraisal rights to certify (i) whether or not beneficial ownership of those shares for which appraisal rights are asserted was acquired before that date and (ii) that the shareholder did not vote for the transaction;

(2) state:

(i) where the form must be sent and where certificates for certificated shares must be deposited and the date by which those certificates must be deposited, which date may not be earlier than the date for receiving the required form under subsection (2)(ii);

(ii) a date by which the corporation must receive the form which date may not be fewer than 40 nor more than 60 days after the date the subsection (a) appraisal notice and form are sent, and state that the shareholder shall have waived the right to demand appraisal with respect to the shares unless the form is received by the corporation by such specified date;

(iii) the corporation's estimate of the fair value of the shares;

(iv) that, if requested in writing, the corporation will provide, to the shareholder so requesting, within ten days after the date specified in subsection (2)(ii) the number of shareholders who return the forms by the specified date and the total number of shares owned by them; and

(v) the date by which the notice to withdraw under section 13.23 must be received, which date must be within 20 days after the date specified in subsection (2)(ii); and

(3) be accompanied by a copy of this chapter.

OFFICIAL COMMENT TO SECTION 13.22

The purpose of section 13.22 is to require the corporation to provide shareholders with information and a form for perfecting appraisal rights. The content of this notice and form are spelled out in detail to ensure that they accomplish this purpose.

When an action is submitted to the vote of shareholders, the appraisal notice must be sent only to those persons who gave notice of their intention to demand appraisal under section 13.21 and did not vote (or permit or cause to be voted) such shares in favor of the proposed action. In a short-form merger under section 11.05, the notice must be sent to all persons who may be eligible for appraisal rights no earlier than the effective date of the merger and no later than ten days thereafter. In either case, the notice must be accompanied by a copy of this chapter.

The notice must supply a form to be used by the person asserting appraisal rights in order to complete the exercise of those rights. Under section 13.22(b)(2)(ii), the notice must specify the date by which the shareholder's executed form must be received by the corporation, which date must be at least 40 days but not more than 60 days after the appraisal notice is sent.

Under section 13.22(b)(2)(i), the notice must also specify where and when share certificates must be deposited; the time for deposit may not be set at a date earlier than the date for receiving the required form under section 13.22(b)(2)(ii).

Sections 13.22(b)(1) and (2)(i) require the corporation to specify in the form supplied for demanding payment where the form must be sent as well as the date of the first announcement of the terms of the proposed corporate action. This is the critical date for determining the rights of shareholder-transferees: persons who became shareholders prior to that date are entitled to full appraisal rights, while persons who became shareholders on or after that date are entitled only to the more limited rights provided by section 13.25. See the Official Comments to sections 13.23 and 13.25. The date set forth in the form should be the date the principal terms of the transaction were announced by the corporation to shareholders. This may be the day the terms were communicated directly to the shareholders, included in a public filing with the Securities and Exchange Commission, published in a newspaper of general circulation that can be expected to reach the financial community, or any earlier date on which such terms were first announced by any other person or entity to such persons or sources. Any announcement to news media or to shareholders that relates to the proposed transaction but does not contain the principal terms of the transaction to be authorized at the shareholders' meeting is not considered to be an announcement for the purposes of section 13.22.

Sections 13.22(b)(2)(iii) and (b)(2)(iv) require the corporation to state its estimate of the fair value of the shares and how shareholders may obtain the number of shareholders and number of shares demanding appraisal rights. The information required by sections 13.22(b)(2)(iii) and (b)(2)(iv) is intended to help shareholders assess whether they wish to demand payment or to withdraw their demand for appraisal, but the information under section 13.22(b)(2)(iv) is required to be sent only to those shareholders from whom the corporation has received a written request. If such request is received, the corporation must respond within ten days after forms are due pursuant to section 13.22(b)(2)(ii). Finally, section 13.22(b)(2)(v) requires the corporation to specify the date by which the shareholder's notice to withdraw under section 13.23 must be received.

*** THIS DOCUMENT IS CURRENT THROUGH THE 2003 EDITION ***

MODEL BUSINESS CORPORATION ACT (1984)
(Incorporating changes through October 1999)
CHAPTER 14. DISSOLUTION
Subchapter A. Voluntary Dissolution

1984 Model Business Corporation Act § 14.02

§ 14.02. Dissolution by Board of Directors and Shareholders.

(a) A corporation's board of directors may propose dissolution for submission to the shareholders.

(b) For a proposal to dissolve to be adopted:

(1) the board of directors must recommend dissolution to the shareholders unless the board of directors determines that because of conflict of interest or other special circumstances it should make no recommendation and communicates the basis for its determination to the shareholders; and

(2) the shareholders entitled to vote must approve the proposal to dissolve as provided in subsection (e).

(c) The board of directors may condition its submission of the proposal for dissolution on any basis.

(d) The corporation shall notify each shareholder, whether or not entitled to vote, of the proposed shareholders' meeting. The notice must also state that the purpose, or one of the purposes, of the meeting is to consider dissolving the corporation.

(e) Unless the articles of incorporation or the board of directors acting pursuant to subsection (c) require a greater vote, a greater number of shares to be present, or a vote by voting groups, adoption of the proposal to dissolve shall require the approval of the shareholders at a meeting at which a quorum consisting of at least a majority of the votes entitled to be cast exists.

OFFICIAL COMMENT TO SECTION 14.02

Section 14.02(b) requires the board of directors, after approving a proposal to dissolve, to submit the proposal to the shareholders for their approval. When submitting the proposal the board of directors must make a recommendation to the shareholders that the plan be approved, unless the board of directors makes a determination that because of conflicts of interest or other special circumstances it should make no recommendation. For example, the board or directors may make such a determination where there is not a sufficient number of directors free of a conflicting interest to approve the proposal or because the board of directors is evenly divided as to the merits of the proposal but is able to agree that shareholders should be permitted to consider dissolution. If the board of directors makes such a determination, it must describe the conflict of interest or special circumstances, and communicate the basis for the determination, when submitting the proposal to dissolve to the shareholders. The exception for conflicts of interest or other special circumstances is intended to be sparingly available. Generally, shareholders should not be asked to act on a proposal for dissolution in the absence of a recommendation by the board of directors. The exception is not intended to relieve the board of directors of its duty to consider carefully the proposed dissolution and the interests of shareholders.

Section 14.02(c) permits the board of directors to condition its submission of a proposal for dissolution on any basis. Among the conditions that a board might impose are that the proposal will not be deemed approved unless it is approved by a specified vote of the shareholders, or by one or more specified classes or series of shares, voting as a separate voting group, or by a specified percentage of disinterested shareholders. The board of directors is not limited to conditions of these types.

Section 14.02(d) provides that if the proposal is required to be approved by the shareholders, and if the approval is to be given at a meeting, the corporation must notify each shareholder, whether or not entitled to vote, of the meeting of shareholders at which the proposal is to be submitted. Requirements concerning the timing and content of a notice of meeting are set out in section 7.05. Section 14.02(d) does not itself require that notice be given to nonvoting shareholders where the proposal is approved, without a meeting, by unanimous consent. However, that requirement is imposed by section 7.04(d).

Section 14.02(e) provides that approval of a proposal for dissolution requires approval of the shareholders at a meeting at which a quorum consisting of a majority of the votes entitled to be cast on the proposal exists. If a quorum is present, then under sections 7.25 and 7.26 the proposal will be approved if more votes are cast in favor of the proposal than against it by the voting group or separate voting groups entitled to vote on the proposal. This represents a change from the Act's previous voting rule for dissolution, which required approval by a majority of outstanding shares.

The Act does not mandate separate voting by voting groups or appraisal rights in relation to dissolution proposals on the theory that, upon dissolution, the rights or all classes or series of shares are fixed by the articles of incorporation. Of course, group voting rights may be conferred by the articles of incorporation or by the board of directors, acting pursuant to subsection (c).

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MODEL BUSINESS CORPORATION ACT (1984)
(Incorporating changes through October 1999)
CHAPTER 16. RECORDS AND REPORTS
Subchapter B. Reports

1984 Model Business Corporation Act § 16.20

§ 16.20. Financial Statements for Shareholders.

(a) A corporation shall furnish its shareholders annual financial statements, which may be consolidated or combined statements of the corporation and one or more of its subsidiaries, as appropriate, that include a balance sheet as of the end of the fiscal year, an income statement for that year, and a statement of changes in shareholders' equity for the year unless that information appears elsewhere in the financial statements. If financial statements are prepared for the corporation on the basis of generally accepted accounting principles, the annual financial statements must also be prepared on that basis.

(b) If the annual financial statements are reported upon by a public accountant, his report must accompany them. If not, the statements must be accompanied by a statement of the president or the person responsible for the corporation's accounting records:

(1) stating his reasonable belief whether the statements were prepared on the basis of generally accepted accounting principles and, if not, describing the basis of preparation; and

(2) describing any respects in which the statements were not prepared on a basis of accounting consistent with the statements prepared for the preceding year.

(c) A corporation shall mail the annual financial statements to each shareholder within 120 days after the close of each fiscal year. Thereafter, on written request from a shareholder who was not mailed the statements, the corporation shall mail him the latest financial statements.

OFFICIAL COMMENT TO SECTION 16.20

The requirement that a corporation regularly submit some financial information to shareholders is appropriate considering the relationship between corporate management and the shareholders as the ultimate owners of the enterprise. This requirement was first added as an amendment in 1979 to the 1969 Model Act.

Section 16.20 has its principal impact on small, closely held corporations, since enterprises whose securities are registered under federal statutes are required to supply audited financial statements to shareholders. The securities of the vast majority of corporations in the United States are not registered under federal law. It is these corporations that section 16.20 principally affects.

Section 16.20 requires every corporation to prepare and submit to shareholders annual financial statements consisting of a balance sheet as of the end of the fiscal year, an income statement for the year, and a statement of changes in shareholders’ equity for the year. The last statement may be omitted if the data that normally appears in that statement appears in the other financial statements or in the notes thereto. Consolidated statements of the corporation and any subsidiary, or subsidiaries, or combined statements for corporations under common control, may be used. Section 16.20 does not require financial statements to be prepared on the basis of generally accepted accounting principles (“GAAP”). Many small corporations have never prepared financial statements on the basis of GAAP. “Cash basis” financial statements (often used in preparing the tax returns of small corporations) do not comply with GAAP. Even closely held corporations that keep accrual basis records, and file their federal income tax returns on that basis, frequently do not make the adjustments that may be required to present their financial statements on a GAAP basis. In light of these considerations, it would be too burdensome on some small and closely held corporations to require GAAP statements. Accordingly, internally or externally prepared financial statements prepared on the basis of other accounting practices and principles that are reasonable in the circumstances, including tax returns filed with the Federal Internal Revenue Service (if that is all that is prepared), will suffice for these types of corporations. If a corporation does prepare financial statements on a GAAP basis for any purpose for the particular year, however, it must send those statements to the shareholders as provided by the last sentence of section 16.20(a).

Section 16.20(b) requires an accompanying report or statement in one of two forms: (1) if the financial statements have been reported upon by a public accountant, his report must be furnished; or (2) in other cases, a statement of the president or the person responsible for the corporation's accounting records must be furnished (i) stating his reasonable belief as to whether the financial statements were prepared on the basis of generally accepted accounting principles, and, if not, describing the basis on which they were prepared, and (ii) describing any respects in which the financial statements were not prepared on a basis of accounting consistent with those prepared for the previous year.

Section 16.20 refers to a "public accountant." The same terminology is used in section 8.30 (standards of conduct for directors) of the Model Act. In various states different terms are employed to identify those persons who are permitted under the state licensing requirements to act as professional accountants. Phrases like "independent public accountant," "certified public accountant," "public accountant," and others may be used. In adopting the term "public accountant," the Model Act uses the words in a general sense to refer to any class or classes of persons who, under the applicable requirements of a particular jurisdiction, are professionally entitled to practice accountancy.

In requiring a statement by the president or person responsible for the corporation's financial affairs, it is recognized that in many cases this person will not be a professionally trained accountant and that he should not be held to the standard required of a professional. To emphasize this difference, section 16.20 requires a "statement" (rather than a "report" or "certificate") and calls for the person to express his "reasonable belief" (rather than "opinion") about whether or not the statements are prepared on the basis of GAAP or, if not, to describe the basis of presentation and any inconsistencies in the basis of the presentation as compared with the previous year. He is not required to describe any inconsistencies between the basis of presentation and GAAP. If the statements are not prepared on a GAAP basis, the description would normally follow guidelines of the accounting profession as to the reporting format considered appropriate for a presentation which departs from GAAP. See, e.g., "Statement on Auditing Standards No. 14" of the American Institute of Certified Public Accountants. For example, the description might state, with respect to a cash basis statement of receipts and disbursements, that the statement was prepared on that basis and that it presents the cash receipts and disbursements of the entity for the period but does not purport to present the results of operations on the accrual basis of accounting.

Section 16.20(c) specifies that annual financial statements are to be mailed to each shareholder within 120 days after the close of each fiscal year, further emphasizing that the statements required to be delivered are annual statements and not interim statements. In addition, if a shareholder was not mailed the corporation's latest annual financial statements, he may obtain them on written request. See also section 16.01(e)(5).

Failure to comply with the requirements of section 16.20 does not adversely affect the existence or good standing of the corporation. Rather, failure to comply gives an aggrieved shareholder rights to compel compliance or to obtain damages, if they can be established, under general principles of law.

UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

Court of Chancery of Delaware.
Joseph ADLERSTEIN, an individual, Plaintiff,
v.
Stephen N. WERTHEIMER, an individual; Judy K. Mencher, an individual; Ilan Reich, an individual; and Spectrumedix Corporation, a Delaware corporation, Defendants.
No. CIV.A. 19101.
Submitted: Nov. 27, 2001.
Decided: Jan. 25, 2002.

Former chairman and chief executive officer (CEO) of corporation, who had been director and controlling stockholder, sued corporation and three individuals who claim to be current directors seeks a determination that board meeting that resulted in his removal and issuance of new class of supervoting preferred stock was not properly convened and that all actions taken at or in conjunction with meeting were null and void. The Court of Chancery, Lamb, Vice Chancellor, held that: (1) telephone conversation between director and chairman was sufficient to provide chairman with notice of board meeting, but (2) directors' decision to keep chairman uninformed about their plan to present proposal to destroy his voting control over corporation for consideration at board meeting invalidated board's approval of proposal at meeting.
So ordered.

West Headnotes

[1] KeyCite Notes

101 Corporations
101X Officers and Agents
101X(B) Authority and Functions
101k298 Meetings of Directors
101k298(3) k. Calling and Notice. Most Cited Cases

Telephone conversation between director and corporation's chairman and chief executive officer (CEO) was sufficient to provide chairman with notice of board meeting, as was required by corporate bylaws, even though chairman was not provided with written notice or meeting agenda.

[2] KeyCite Notes

101 Corporations
101X Officers and Agents
101X(B) Authority and Functions
101k298 Meetings of Directors
101k298(3) k. Calling and Notice. Most Cited Cases

Directors' decision to keep insolvent corporation's chairman, director, and controlling stockholder uninformed about their plan to present proposal to terminate chairman and approve acquisition of corporation by outside investor for consideration at board meeting invalidated board's approval of proposal at meeting; chairman was entitled to know ahead of time of plan to issue new class of supervoting preferred stock to investor with purposeful effect

of destroying chairman's voting control over corporation, given his contractual power to prevent issuance of stock by executing written consent removing other directors from board.
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MEMORANDUM OPINION

LAMB, Vice Chancellor.

I.

***1** This is an action pursuant to Section 225 of the Delaware General Corporation Law ("DGCL") brought by Joseph Adlerstein, the former Chairman and CEO of SpectruMedix Corporation ("SpectruMedix" or "the Company"), a Delaware corporation. SpectruMedix is in the business of manufacturing and selling instruments to the genetics and pharmaceutical industries and is headquartered in State College, Pennsylvania. Adlerstein's complaint is against the Company and three individuals who claim to be the current directors of the Company: Steven N. Wertheimer, Judy K. Mencher, and Ilan Reich.

At issue in the Complaint are a series of actions taken on July 9, 2001, at or in conjunction with a purported meeting of the SpectruMedix board of directors held at the New York City offices of McDermott, Will & Emery ("MW & E"). [FN1] First, a board majority (consisting of Wertheimer and Mencher) voted to issue to the I. Reich Family Limited Partnership ("Reich Partnership"), an entity affiliated with Reich, a sufficient number of shares of a new class of supervoting preferred stock to convey to the Reich Partnership a majority of the voting power of the Company's stock. Second, the same majority voted to remove Adlerstein for cause as Chief Executive Officer of the Company, to strip him of his title as Chairman of the Board, and to appoint Reich to serve as Chief Executive Officer and as Chairman of the Board. Third, immediately after the board meeting, the Reich Partnership executed and delivered to SpectruMedix a written consent in lieu of stockholders meeting purporting to remove Adlerstein as a director. When the dust settled, the board consisted of Wertheimer, Mencher, and Reich; the Reich Partnership had replaced Adlerstein as holder of majority voting control; and Reich had replaced Adlerstein as Chairman and CEO.

FN1. Over the years Adlerstein was represented in various personal capacities by Stephen Selbst, a partner in MW & E's New York City office. Eventually Selbst also began to serve as counsel to SpectruMedix. Selbst was present at the July 9 meeting and, as counsel to SpectruMedix, schemed with Wertheimer, Mencher, and Reich to engineer Adlerstein's ouster.

Adlerstein seeks a determination that the July 9 meeting was not properly convened and, therefore, all actions taken at or in conjunction with that meeting are null and void. Adlerstein also contends that, even if the meeting was duly noticed and convened, the actions taken at the meeting by Wertheimer and Mencher were the product of a breach of the fiduciary duties they owed to him in his capacity as a director and the controlling stockholder.

II.

Adlerstein is a scientist and entrepreneur. He has a Ph.D. in physics and was involved with the funding and management of a number of start-up technology companies before founding SpectruMedix (originally named Premier American Technologies Company) in 1992.
Wertheimer, an investment banker, was introduced to Adlerstein by Selbst [FN2] and was elected to the board by Adlerstein on January 1, 2000. Mencher is a money manager with an expertise in high yield and distressed investments. On Wertheimer's recommendation, Adlerstein elected Mencher to the board on March 22, 2000.

FN2. *See supra* note 1.

In 1997, SpectruMedix completed an initial public offering of its common stock, raising net proceeds of $4.67 million, more than half of which was used to repay existing indebtedness. SpectruMedix experienced substantial net losses over the next several years, "burning" through all of the cash raised in the IPO.

***2** In July 1999, SpectruMedix entered into a series of agreements with Applied Biosystems, Inc. and certain of its affiliates. As a result of these agreements SpectruMedix received $5 million in cash in exchange for a sublicense to certain technology licensed by SpectruMedix, shares of SpectruMedix Series A Preferred Stock, and a consulting agreement. Following this transaction, apart from a small amount of revenue from the sale of instruments and related disposable products, SpectruMedix received no other funds between July 31, 1999 and July 9, 2001.

In 1999, to avoid a liquidity crisis, Adlerstein loaned SpectruMedix $500,000. In exchange, SpectruMedix gave Adlerstein a note that was convertible (at Adlerstein's option) into shares of a new Series B Preferred Stock of SpectruMedix that voted with the common and carried 80,000 votes per share. In January 2000, Adlerstein converted approximately $103,000 outstanding under this loan agreement into shares of Series B Preferred Stock. As a result, although Adlerstein owned only 21.41% of the equity of SpectruMedix, he controlled 73.27% of the voting power of the Company.

Late in 1999, before joining the board, Wertheimer convinced Adlerstein to hire Manus O'Donnell, an independent management consultant, to study and report on the status of the Company's management and finances. O'Donnell conducted his study and delivered a report dated January 2, 2000, in which he concluded that, unless the Company began making sales of instruments, it had sufficient cash and cash equivalents to continue operations only until September 2001.

During September 2000, as a result of increasing concern over SpectruMedix's deteriorating financial condition, Wertheimer and Mencher convinced Adlerstein to re-hire O'Donnell. On September 15, 2000, O'Donnell updated his report, shortening the period during which sufficient cash reserves were forecasted. He stated:

[S]ince my last forecast in December, the company burn rate has increased substantially ... mainly due to increased headcount expense. As a result cash would last until May 2001 if grant money is received as predicted (at 115K per month from October onward). If grants are not received, then cash would be exhausted in January 2001.

As O'Donnell noted, the change in forecast was due in large part to Adlerstein's decision to increase staffing levels from 23 to 51. This headcount increase resulted in an escalation of the annual payroll by just over 100%. O'Donnell concluded by telling the board of directors that, at the then-current level of fixed expenses, SpectruMedix needed to sell and get paid for one machine per month in order to maintain an adequate cash position.

On March 28, 2001, a sexual harassment complaint was made against Adlerstein asserting that he threatened an employee's job because she objected to his inappropriate behavior toward her. An independent consultant was hired who, after an investigation, concluded that Adlerstein had been guilty of sexual harassment as defined in the Company's policy and had been less than candid in connection with the investigation. The consultant made an oral report of this conclusion to Wertheimer and Mencher on May 14, 2001. Because Adlerstein failed to pay the consultant's bill, a written report detailing the investigation was not delivered to the Company until September 2001.

***3** On April 11, 2001, a meeting of the SpectruMedix board was held. At that meeting Adlerstein represented to the board, and the minutes of the meeting state, that three instruments had been purchased and shipped during the quarter ending March 31, 2001 and the Company was projecting sales of six to nine instruments for the quarter ending June 30, 2001. In fact, according to uncontroverted testimony, the Company sold only one instrument during the quarter ending March 31, 2001 and that sale was made on the condition that

SpectruMedix would further develop the instrument to a commercially viable level of functionality.

During April 2001, Wertheimer and Mencher convinced Adlerstein to again hire O'Donnell to generate an updated report on the financial condition of the Company. The resulting report, which projected a cash balance of $66,000 for the Company as of May 31, 2001, was discussed at an April 30, 2001 meeting of the board. As reflected in the board's minutes for that meeting Adlerstein on the one hand and Wertheimer and Mencher on the other had very different reactions to the Company's financial state:

[Adlerstein] did not regard the situation as quite as desperate as the other directors. He said that the Company had previously faced similar cash crises and had weathered them. He said that he had found money to keep the Company alive in the past, and if required to do so again, he would find the resources. Mr. Wertheimer and Ms. Mencher lauded him for his past efforts to save the Company, but said that the[y] were seeking to bring the Company to a cash neutral or profitable position as promptly as possible. The point, Ms. Mencher said, was to put the Company in a position where Dr. Adlerstein wouldn't be required to keep the Company afloat personally in the future. [FN3]

FN3. Def. Ex. ("DX") 18 at 1.

This divergence in perspective continued through the July 9 meeting.

The board met again on May 25, 2001. Adlerstein reported that the Company was "low on cash" but delivered an upbeat report on the status of discussions he was having with several potential strategic partners. Wertheimer and Mencher remained concerned about the Company's deteriorating financial condition and began to question seriously the information Adlerstein was providing to them. As Mencher testified:

[I]t became clear that we were not getting the entire picture of what was going on with the company and that the company was quickly heading ... toward a major liquidity crisis--if it wasn't already in one--and that the company needed a crisis manager, just for somebody to get in and tell the board what was really going on and how long the company had to survive. [FN4]

FN4. Transcript of Trial Testimony ("Tr.") at 172-73.

Thus, Wertheimer and Mencher suggested that the Company should again hire O'Donnell's firm to help the Company in reducing expenses and improving the instrument manufacturing process. Adlerstein agreed, and the entire board unanimously resolved to do so. O'Donnell and his colleague, Gordon Mason, agreed to take on such an assignment provided SpectruMedix execute a written consulting agreement.

***4** During the month of June 2001, O'Donnell and members of his firm began to play a hands-on role at the Company's headquarters, reducing the number of employees while improving the instrument manufacturing process. Among other things, they drew up an organizational chart that defined lines of authority and responsibility in the Company, something Adlerstein had refused to do. These changes were met enthusiastically by the Company's senior employees.

Adlerstein conducted a rearguard action against O'Donnell's restructuring efforts. Most notably, he refused to sign a written contract with O'Donnell, notwithstanding the direction of the board that he do so. He also was frequently away from headquarters in State College during June but, when he did appear, acted to undo changes that had been implemented. Eventually, O'Donnell and Mason stopped working. Wertheimer and Mencher concluded that Adlerstein was intentionally impeding the progress of the consultants and resolved to investigate the situation at SpectruMedix for themselves.

Wertheimer contacted three of the four department heads at the Company and learned that these individuals were planning to quit their jobs with SpectruMedix if organizational and other changes implemented by the consultants were not kept in place. On July 2, 2001, O'Donnell forwarded a report to Wertheimer and Mencher which concluded that Adlerstein was "the central problem" at the Company, because "he is totally lacking in managerial and business competence and has demonstrated an unwillingness to accept these shortcomings." [FN5] O'Donnell further opined: "For SpectruMedix to have any chance, [Adlerstein] must be removed from any operating influence within the company." [FN6]

FN5. DX 28 at 2.

FN6. *Id.*

In June 2001, Wertheimer contacted Reich to discuss involving him as both an investor and manager of SpectruMedix. Wertheimer knew that Reich had the personal wealth and managerial experience to take on a restructuring of SpectruMedix. [FN7] As he testified at trial: "Ilan was the only guy I knew that had money and had the skills to go in and ... pull this out of the fire.... No institutional investor would go anywhere near a company like this. It had to be somebody that liked to get his hands dirty, who liked to go into a company and basically try and make something out of something that was in a lot of trouble." [FN8]

FN7. Wertheimer was aware that in the mid-1980s Reich had pleaded guilty to federal charges of trading on inside information while he was a partner in a prominent New York City law firm and served a one-year prison sentence. Nevertheless, he also knew that, from 1998 to 2000, Reich was employed as the President and CEO of Inamed Corporation, a publicly traded company, and had accomplished a significant turnaround of that company. Wertheimer knew that Reich had left Inamed in 2001 and might be interested in a new challenge.

FN8. Tr. at 312.

On June 27, 2001, Reich met with Selbst and O'Donnell to discuss the business of SpectruMedix. Adlerstein was unaware of this meeting. The next day, Reich and Adlerstein met in New York. Reich testified that he then determined that he would only be willing to invest in SpectruMedix if he, and not Adlerstein, were in charge of the Company. Reich thereafter executed a confidentiality agreement and received non-public information in due diligence.

On June 30, Reich sent an e-mail to Selbst that referred to an upcoming meeting between Selbst and Wertheimer for the purpose of discussing Adlerstein's Series B Preferred shares. Adlerstein was not copied on this e-mail and was not aware of this meeting. Also on June 30, Wertheimer had a discussion with Reich about firing Adlerstein.

***5** On July 2, 2001, Reich participated in a conference call with Wertheimer and Mencher and later that day met with Wertheimer to discuss his potential investment. At that meeting, the option of firing Adlerstein for cause from his position as CEO due to his sexual harassment of a Company employee was discussed, as was Adlerstein's voting control over the Company. Adlerstein had no idea this meeting was taking place. But by this time Reich knew he would have an opportunity to take over SpectruMedix.

On July 3, 2001, Reich met with various department heads of the Company during a due diligence visit to the SpectruMedix headquarters. Aware of this visit, Adlerstein acted to discourage senior officials at State College from cooperating fully with Reich. As he e-mailed one of the Company's principal scientists:

I am not willing to have you spend an inordinate amount of time satisfying [Reich's] ... requests at the risk of exposing our innards (i.e.technologies, analysis) to someone ... who, in the final analysis, is by no means a sure thing to invest in [SpectruMedix]. [FN9]

> FN9. DX 29.

A. SpectruMedix's Insolvency

By the beginning of July 2001, if not earlier, SpectruMedix was either insolvent or operating on the brink of insolvency. [FN10] The Company had very little cash (or cash equivalents) and no material accounts receivable due. At the same time, the Company had substantial and increasing accounts payable, Adlerstein was not communicating with creditors, and key parts vendors were refusing to make deliveries unless paid in cash. Indisputably, SpectruMedix did not have sufficient cash on hand to meet its next employee payroll on July 13, 2001, and had no realistic expectation of receiving sufficient funds to do so from its operations. Moreover, the Company's auditors were unwilling to issue the opinion letter necessary for it to file an annual report with the SEC, which was due to be filed on July 10th.

> FN10. According to DX 34, an unaudited balance sheet as of June 30, 2001, SpectruMedix had $89,293 in cash and certificates of deposit and $2,404,135 in accounts payable.

B. The July 9, 2001 Board Meeting

1. Notice

Wertheimer testified that, on or about July 5, 2001, he and Adlerstein spoke on the telephone about the deteriorating financial condition of the Company and matters relating to a significant arbitration involving SpectruMedix. [FN11] In that proceeding, MW & E had moved to withdraw as counsel to SpectruMedix, as a result, among other things, of disputes over non-payment of fees and expenses. Wertheimer and Adlerstein may have discussed the fact that the arbitrator planned to hold a conference on the motion to withdraw on Monday, July 9, and wished to be able to speak to Adlerstein by telephone. Wertheimer testified that, during this conversation, Adlerstein agreed to convene a meeting of the board of directors at 11 a.m. on July 9, 2001, at MW & E's New York City offices. Wertheimer further testified that Adlerstein was aware that the topics to be discussed at the meeting would be (i) SpectruMedix's dire financial condition and immediate need for cash, (ii) the arbitration, including the need to retain new counsel, (iii) the formal execution of an agreement to retain O'Donnell, and (iv) the Company's certified public accountants' refusal to issue an audit opinion. Adlerstein maintains that, while he agreed to meet with Wertheimer on July 9 in MW & E's offices, the only purpose of that meeting was to be available to speak to the arbitrator about the motion to withdraw. He denies that he ever agreed to call a board meeting for that time or knew that one was to be held.

> FN11. The other party to the arbitration was Iowa State University Research Foundation, the licensor of core technologies used in SpectruMedix's instrumentation. The arbitration posed a substantial risk to the future viability of SpectruMedix.

***6** The trial record contains plainly divergent testimony on the subject of whether Adlerstein called the July 9 meeting or was given notice of it. Mencher, Reich, and Selbst all support Wertheimer's testimony, although they all learned about the meeting from Wertheimer. Thus, while their testimony is corroborative of his, it provides no independent evidence of Adlerstein's state of knowledge. Adlerstein's trial testimony was undermined by Karl Fazler, the Company's business manager, who spoke with Adlerstein on the morning of July 9, and remembered Adlerstein telling him that he was on his way to MW & E's offices in order to meet with the board of directors. [FN12] At the same time, Adlerstein's testimony is buttressed, to some degree, by the fact that none of the directors received written notice of a meeting although,the evidence suggests, SpectruMedix usually circulated notice and a proposed agenda by e-mail. [FN13]

FN12. On cross-examination, Fazler re-affirmed his recollection that Adlerstein had said he was going to meet with the board, conceding only that it was "possible" Adlerstein had said he was going to meet with a board member, rather than to a board meeting. Adlerstein did not take the stand to rebut Fazler's testimony.

FN13. There appear in evidence notices or agendas for board meetings of SpectruMedix dated May 9, June 20, and December 7, 2000 and April 10, April 27, and May 25, 2001. These were usually drafted by Selbst and e-mailed by him to the board members. The fact that he and Adlerstein were not on "talking terms" by this point due to his firm's unpaid legal bills may account for the lack of either a written notice or agenda for the July 9, 2001 meeting. There was no agenda and no minutes, however, for a board meeting that occurred in January 2001 in Boston, which supports Defendants' assertion that not all board meetings were formally noticed.

2. Adlerstein was kept in the dark about the Reich proposal

Mencher's notes show that Reich first proposed terms for an acquisition of SpectruMedix no later than July 5. On that date, she had a teleconference with Wertheimer and Reich in which they discussed the outline of the transaction and the need to terminate Adlerstein. Her notes contain the entry "fire Joe + negotiate a settlement," followed by a summary of terms for his separation.

The documents necessary for a transaction with Reich were in draft form by July 6, 2001. Selbst sent these documents by e-mail to Wertheimer, Mencher, and Reich. He did not send them to Adlerstein, who was deliberately kept unaware that Reich had made a proposal until the July 9 meeting. At trial, Wertheimer was asked whether "[b]etween the time you got the proposal from Mr. Reich-- until the time you walked in to the board meeting on July 9th, did you tell Doctor Adlerstein that you were negotiating a proposal with Ilan Reich ...." He responded that he had not:

A. Because I wanted to save the company at that point.... So, no, I didn't tell him that this was going on, because I had no faith that he would--that he would, first of all, you know, go along with the deal; but secondly, I was also worried that he would do something to scare off the investor. [FN14]

FN14. Tr. at 326-27.

Although Adlerstein argues that the Reich proposal was finalized on Friday, July 6, the record supports the conclusion that Reich and Wertheimer were still negotiating some terms of the deal on the morning of July 9 and that final documents were not ready until that time. The deal finally negotiated provided, subject to board approval, that the Reich Partnership would invest $1 million in SpectruMedix, Reich would assume the active management of SpectruMedix, and SpectruMedix would issue shares of its Series C Preferred Stock to the Reich Partnership carrying with them voting control of the Company.

3. The meeting occurs

Adlerstein arrived late at MW & E's New York City offices to find Selbst and Wertheimer waiting for him. He inquired about the conference with the arbitrator and was told that the matter had been postponed. Mencher was hooked in by phone and, according to Wertheimer, Adlerstein called the meeting to order and "wanted to talk about lawyers and the arbitration." [FN15] Wertheimer then interrupted and said that they needed to talk about finances. He then told Adlerstein that there was a proposal from Reich and handed him a term sheet showing the material elements of the deal. [FN16]

FN15. *Id.* at 333.

FN16. *Id.*

***7** After reviewing it, Adlerstein told Wertheimer and Mencher that he was not interested in the Reich proposal because it would dilute his shares in the Company and result in him losing voting control. He has since testified that his lack of interest was also because he believed the price of $1 million to be insufficient for control of SpectruMedix. He did not, however, voice this concern at the time.

In response to the objection that he did voice, Wertheimer and Mencher explained that in their judgment the Company was in immediate need of funds and the investment by Reich was needed to avoid liquidation. Wertheimer asked Adlerstein directly if he was personally in a position to provide the needed funds. Adlerstein responded that he was not.

Wertheimer and Mencher tried to engage Adlerstein in further discussion about the Reich proposal, but Adlerstein sat silent. He testified that the reason for his silence was advice given to him by Selbst in the past: "when in doubt about what to do in a situation like this, keep your mouth shut." [FN17] Because he and Mencher could not get Adlerstein to engage in any dialogue regarding the proposed transaction, Wertheimer moved the transaction for a vote. Wertheimer testified:

FN17. Tr. at 71.

There was no use in talking about it, because [Adlerstein] wouldn't talk.... So the fact that the discussion didn't go any longer, the finger should not be pointed at us, it should be pointed at the person that cut off the discussion. That is Doctor Adlerstein . [FN18]

FN18. Tr. at 372-73.

Adlerstein has testified that when the vote on the transaction was called he did not participate. The minutes of the meeting reflect that he voted "no." Each of the others present at the meeting--Wertheimer, Mencher, and Selbst-- confirms the statement in the minutes. [FN19]

FN19. Adlerstein also testified that, when he realized Wertheimer and Mencher were prepared to act against his interests, he asked Selbst about using his voting power to prevent this from happening. According to Adlerstein, Selbst told him that he could not, due to a 10-day notice requirement for convening a meeting of shareholders. The others deny that

this exchange took place. According to the minutes of the July 9 meeting, the second item of business was an amendment to the Company's bylaws, approved by a vote of 2 to 1, with Adlerstein opposed. Prior to its amendment, the bylaw purported to proscribe shareholder action by written consent. Of course, this bylaw was very likely unenforceable as a matter of Delaware law. *Datapoint Corp. v. Plaza Sec. Co.*, 496 A.2d 1031, 1035 (Del.1985). The importance of this bylaw and its effect on Adlerstein's right to remove Wertheimer and Mencher was not explored by the parties at trial.

The board then took up the question of removing Adlerstein "for cause" from his office as CEO and Chairman of SpectruMedix. The elements of "cause" assigned were mismanagement of the Company, misrepresentations to his fellow board members as to its financial situation, and sexual harassment in contravention of his employment contract. After the meeting, the Reich Partnership executed and delivered a stockholder's written consent removing Adlerstein as a director of SpectruMedix. Reich was chosen to replace him.
Some months after July 9, Adlerstein executed a written consent purporting to vote his Series B Preferred shares to remove Wertheimer and Mencher from the board. Adlerstein initiated this Section 225 action on September 11, 2001.

III.

The general purpose of Section 225 is to provide "a quick method of review of the corporate election process in order to prevent a corporation from being immobilized by controversies as to who are its proper officers and directors." [FN20] Because it is summary in nature, a Section 225 proceeding is limited to those issues that must necessarily be considered in order to resolve a disputed corporate election process. [FN21] A Section 225 action focuses narrowly on the corporate election at issue and is not an appropriate occasion to resolve matters ancillary or secondary to that election. [FN22]

FN20. *Bossier v. Connell,* 1986 Del. Ch. LEXIS 471, at *5 (Del. Ch. Oct. 7, 1986).

FN21. *Box v. Box*, 697 A.2d 395, 398 (Del.1997).

FN22. *Arbitrium Handels AG v. Johnston,* 1997 Del. Ch. LEXIS 132, at *11 (Del. Ch. Sept. 17, 1997).

***8** Here, the question is whether the meeting held on July 9 was a meeting of the board of directors or not. If it was not, Adlerstein continues to exercise a majority of the voting power and is now the sole lawful director. If it was, I must then address a welter of arguments advanced by Adlerstein to prove that the actions taken at the July 9 meeting ought to be invalidated because Wertheimer and Mencher (and Selbst) all operated in secret to negotiate terms with Reich while keeping Adlerstein deliberately uninformed about their plan to present the Reich proposal at the July 9 meeting. The more persuasive of these arguments are predicated largely on the decisions of the Court of Chancery in *VGS, Inc. v. Castiel* [FN23] and *Koch v. Stearn.* [FN24]

FN23. 2000 Del. Ch. LEXIS 122 (Del. Ch. Aug. 31, 2000).

FN24. 1992 Del. Ch. LEXIS 163 (Del. Ch. July 28, 1992).

Finally, if all else fails, Adlerstein argues that Wertheimer and Mencher violated their fiduciary duties of care and loyalty to SpectruMedix in approving the Reich transaction with inadequate information and on terms that were unfair to the Company and its stockholders. He asks for an order canceling the shares and disregarding any effort by Reich to vote them.
For the reasons next discussed, I conclude that, although the meeting of July 9 was called as a board meeting, the actions taken at it must be invalidated. Thus, it is unnecessary to reach the last issue presented by Adlerstein.
A. The Call Of The Meeting

[1] On balance, the evidence at trial indicates that Adlerstein called the July 9 meeting. The procedure for giving notice of a board meeting is typically set forth in a Company's certificate or bylaws. The bylaws of SpectruMedix provide that special meetings of the board "may be called by the president on two (2) days' notice to each director by mail or forty-eight (48) hours notice to each director either personally or by telegram...." [FN25] I credit Wertheimer's account of his July 5 telephone call with Adlerstein. There is no reason to believe that Adlerstein would not have agreed to convene a board meeting on July 9, in view of the many urgent problems confronting SpectruMedix at that time. Fazler's testimony that Adlerstein called him on the morning of the meeting and said that he was on his way to a board meeting provides additional support for Wertheimer on this point. [FN26]

FN25. Bylaws at Article III, Section 7.

FN26. This conclusion makes it unnecessary to decide if Adlerstein's decision to remain at the meeting for its duration amounted to a waiver of notice and objection. Section 229 of the DGCL provides, as follows:

Whenever notice is required to be given under any provision of this chapter or the certificate of incorporation or bylaws ... [a]ttendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when the person attends a meeting for the express purpose of objecting at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

DEL. CODE ANN. tit. 8, § 229 (2001). This section of the law has been applied to waive any defect with respect to notice when a director attends and participates in a meeting despite imperfect notice. *Koch v. Stearn,* 1992 Del. Ch. LEXIS 163, at *12.

In reaching this conclusion, I have considered and reject Adlerstein's argument that the lack of any written notice or agenda for the July 9 meeting proves that it was not a board meeting. Concededly, the record supports Adlerstein's contention that, on many other occasions, someone, usually Selbst, distributed notices and agendas for board meetings of SpectruMedix. Nevertheless, the SpectruMedix bylaws do not require either written notice or the advanced distribution of a proposed agenda. Moreover, the record shows that, on other occasions, meetings of the board of directors were held without written notice or an agenda. [FN27]

FN27. One such meeting was held in Boston in January 2001.

B. The Validity Of The Actions Taken At The July 9 Meeting

***9** [2] A more difficult issue is whether the decision of Wertheimer, Mencher, and Selbst (no doubt with the knowledge of Reich) to keep Adlerstein uninformed about their plan to present the Reich proposal for consideration at the July 9 meeting invalidates the board's approval of that proposal at the meeting.

There are several factors that weigh against a finding of invalidity. The first is the absence from SpectruMedix's bylaws of any requirement of prior notice of agenda items for meetings of the board of directors, coupled with the absence of any hard and fast legal rule that directors be given advance notice of all matters to be considered at a meeting. Second, is the good faith belief of Wertheimer and Mencher that Adlerstein should be removed from management and that, if they had told him about the Reich proposal ahead of time, he would have done something to kill the deal. Third, is the fact of SpectruMedix's insolvency and the argument that the exigencies created by that insolvency gave Wertheimer and Mencher legal warrant to "spring" the Reich proposal on Adlerstein without warning.

Ultimately, I am unable to agree that these factors, either singly or in the aggregate, provide legal justification for the conduct of the July 9 meeting. Instead, I conclude that in the context of the set of legal rights that existed within SpectruMedix at the time of the July 9 meeting, Adlerstein was entitled to know ahead of time of the plan to issue new Series C Preferred Stock with the purposeful effect of destroying his voting control over the Company. This right to advance notice derives from a basic requirement of our corporation law that boards of directors conduct their affairs in a manner that satisfies minimum standards of fairness.

Here, the decision to keep Adlerstein in the dark about the plan to introduce the Reich proposal was significant because Adlerstein possessed the contractual power to prevent the issuance of the Series C Preferred Stock by executing a written consent removing one or both of Wertheimer and Mencher from the board. He may or may not have exercised this power had he been told about the plan in advance. But he was fully entitled to the opportunity to do so and the machinations of those individuals who deprived him of this opportunity were unfair and cannot be countenanced by this court. [FN28]

FN28. The outcome in this case flows from the fact the Adlerstein was both a director and a controlling stockholder, not from either status individually. In the absence of some special contractual right, there is no authority to support the argument that Adlerstein's stockholder status entitled him to advance notice of actions proposed to be taken at a meeting of the board of directors. The actions may be voidable if improperly motivated. *Condec v. Lunkenheimer,* 230 A.2d 769 A.2d 769 (Del. Ch.1967). But the absence (or presence) of notice is not a critical factor. Similarly, in the absence of a bylaw or other custom or regulation

requiring that directors be given advance notice of items proposed for action at board meetings, there is no reason to believe that the failure to give such notice alone would ordinarily give rise to a claim of invalidity. *Dillon v. Berg,* 326 F.Supp. 1214, 1221 (D.Del.), *aff'd,* 453 F.2d 876 (3d Cir.1971). Nevertheless, when a director either is the controlling stockholder or represents the controlling stockholder, our law takes a different view of the matter where the decision to withhold advance notice is done for the purpose of preventing the controlling stockholder/director from exercising his or her contractual right to put a halt to the other directors' schemes.

This result is consistent with the results reached in similar cases. For example, in *VGS, Inc. v. Castiel,* [FN29] the court struck down a merger approved by the written consent of two out of three managers of a Delaware LLC for the purpose of transferring voting control over the enterprise from one member to another. Because the disadvantaged member (who was the third manager) possessed the power to remove one of the other two managers and, thus, could have prevented the merger from happening, the court concluded that it was a breach of the duty of loyalty for the others to have acted in secret to effect the transaction. As then Vice Chancellor (now Justice) Steele wrote:

FN29. 2000 Del. Ch. LEXIS 122 (Del. Ch. Aug. 31, 2000).

***10** While a majority of the board acted by written consent, as all involved surely knew, had the original member's manager received notice beforehand that his appointed manager contemplated action against his interests he would have promptly attempted to remove him. Because the two managers acted without notice to the third manager under circumstances where they knew that with notice ... he could have acted to protect his majority interest, they breached their duty of loyalty to the original member and their fellow manager by failing to act in good faith. [FN30]

FN30. *Id.* at *2-3.

Adlerstein argues that the rationale of *VGS* operates *a fortiori* in this case because the documents that governed the LLC in *VGS* allowed the LLC's managers to act by non-unanimous written consent. Thus, there was no legal necessity for them to meet with the third manager at all. Despite this unusual governance provision, the court ruled that the two managers owed a fiduciary duty to the other, in both his managerial and membership capacities, to disclose their plan to authorize the dilutive merger in order to allow him to exercise his voting control to protect his controlling position. Here, Wertheimer and Mencher could not act outside of a meeting and could not convene a meeting without notice to Adlerstein. Thus, Adlerstein argues,

their obligation to give him advance notice of the Reich proposal is even clearer.
It is difficult to accept this argument fully because the absence of a meeting was itself a fundamental problem in *VGS.* If there had been a meeting, it is likely that Castiel, the controlling member, would have had some opportunity to protect himself at that time by immediately removing the third manager from office. Here, by contrast, there was a meeting, and Adlerstein had *some* notice of the Reich proposal before it was approved by the SpectruMedix board of directors. The question is whether he had an adequate opportunity to protect his interests.
The same question has been addressed in other cases, most notably, in *Koch v. Stearn.* [FN31] In that case, there was a four-person board of directors and two stockholders, Stearn and Koch, each of whom had the right to appoint (and remove) two directors. Due to substantial financial pressures on the Company, three of the directors decided that Stearn should be removed from his positions as Chairman and Chief Executive Officer. They invited Stearn and his counsel to attend a meeting but did not send to either of them the draft resolutions that they had circulated among themselves calling for Stearn's removal. The board met and, over Stearn's vigorous objection, adopted the resolutions. Either then, or later in the meeting, Stearn called for his designee to quit the board but did not execute the written consent of stockholders necessary under Section 228 of the DGCL to effect the removal and replacement of that director.

FN31. 1992 Del. Ch. LEXIS 163 (Del. Ch. July 28, 1992).

The court concluded that Stearn's presence at the meeting was obtained by trickery or deceit because his fellow directors hid from him their plans for his ouster. Alternatively, the court found that, even if Stearn had waived his objection to the meeting by remaining and participating, the actions taken were, nonetheless, void, for the following reasons:
***11** I find that Stearn was disadvantaged by the other directors' failure to communicate their plans to him. If Stearn had seen the draft resolutions before the meeting, he could have exercised his right to remove [his designee] as a director and he could have replaced [him] with another nominee who would vote with Stearn to block Stearn's removal. Without doubt, Stearn's inability to thus protect himself constituted a disadvantage. [FN32]

FN32. *Id.* at *15.

It is equally the case here that Adlerstein was disadvantaged "by the other directors' failure to communicate their plans to him." Had he known beforehand that Wertheimer and Mencher intended to approve the Reich proposal and to remove him from office at the July 9 meeting, he could have exercised his legal right to remove one or both of them and, thus, prevented the completion of those plans. The authority of both *Koch* and *VGS* strongly support the conclusion that Adlerstein had a right to such advance notice in order that he might have taken steps to protect his interests.
Wertheimer and Mencher argue that SpectruMedix's dire financial circumstances and actual or impending insolvency justify their actions because, they believe, it was necessary to keep Adlerstein uninformed in order for them to "save the Company." From the record at trial, it is fair to conclude that SpectruMedix was insolvent as of July 9, 2001, in the sense that it was unable to meet its obligations as they came due. This was already true of ordinary supply contracts and fees for its attorneys and consultants. It was also about to be true for a payroll due a few days after the July 9 meeting. Nevertheless, I conclude that these facts do not alter the outcome of the case. Quite the opposite, it is in such times of dire consequence that the well established rules of good board conduct are most imporant.
While it is true that a board of directors of an insolvent corporation or one operating in the

vicinity of insolvency has fiduciary duties to creditors and others as well as to its stockholders, [FN33] it is not true that our law countenances, permits, or requires directors to conduct the affairs of an insolvent corporation in a manner that is inconsistent with principles of fairness or in breach of duties owed to the stockholders. Indeed, in both *VGS* and *Koch* the directors taking the challenged action argued unsuccessfully that the corporation's dire financial condition and other compelling business circumstances either justified their acts or, at least, served to put the complaining director on notice that they might act against him or his interests.

FN33. *McDonald v. Williams,* 174 U.S. 397, 404-05, 19 S.Ct. 743, 43 L.Ed. 1022 (1899); *Geyer v. Ingersoll Publications Co.,* 621 A.2d 784, 787 (Del.Ch.1992); *Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.,* 1991 Del. Ch. LEXIS 215, at *108 (Del. Ch. Dec. 30, 1991).

There is authority in this court suggesting the possibility that a board of directors could, "consistent with its fiduciary duties, issue a dilutive option in order to protect the corporation or its minority shareholders from exploitation by a controlling shareholder who was in the process of threatening to violate his fiduciary duties to the corporation." [FN34] Nevertheless, neither this nor any other authority suggests that directors could accomplish such action through trickery or deceit, and I am not prepared to hold otherwise. [FN35]

FN34. *Mendel v. Carroll,* 651 A.2d 297, 306 (Del.Ch.1994).

FN35. Of course, as Chancellor Allen noted in *Mandel,* "if the principal motivation for such dilution is simply to maintain corporate control ... it would violate the norm of loyalty." 651 A.2d at 304. This principle was firmly established in *Condec,* 230 A.2d 769. The corollary proposition would appear to be equally true: i.e., an action taken primarily to divest a stockholder of control and transfer that control to another would also seem afoul of "the norm of loyalty."

IV.

***12** For all the foregoing reasons, I have concluded that the actions taken at the July 9, 2001 meeting must be undone. Nevertheless, I recognize that the financial and business condition of SpectruMedix has changed materially since July 9, 2001. I also note plaintiff's proposal, during the trial, that I should appoint a custodian for SpectruMedix rather than reinstate Adlerstein's control. Under these circumstances, before entering a final order, the court will solicit the parties' views as to the appropriate form of relief. To this end, I direct that the parties confer, through counsel or otherwise, in an effort to agree upon the form of an order implementing this decision. Such agreement, of course, will be without prejudice to any party's rights in relation to this decision. If the parties are unable to agree on a form of order, they are directed to submit letter memoranda by 5 p.m. on February 7, 2002, addressed to the appropriate form of relief.
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