

SHAREHOLDERS ON SHAKY GROUND: SECTION 271'S REMAINING LOOPHOLE

Alex Righi

ABSTRACT—The Delaware General Corporation Law (DGCL) is the nation's most popular and respected corporate legal regime for numerous reasons, including the DGCL's clarity and emphasis on "private ordering," the Delaware Court of Chancery's unique corporate legal expertise, and the Delaware legislature's consistent review and amendment of the DGCL. As a result, the DGCL's application is predictable, which lends confidence to corporate decisionmaking and governance. Loopholes in the DGCL—though few—nevertheless exist, through which a corporation could potentially thwart the spirit of the DGCL. Section 271 of the DGCL is one such loophole. Section 271 of the DGCL governs the sale of "all or substantially all" of a corporation's assets. Enacted to provide greater protection to shareholders in major corporate decisions, Section 271 requires parent-level shareholder approval for a corporation—or a parent corporation's fully owned subsidiary—to sell all of its assets. But, despite several revisions since its incorporation in the DGCL, Section 271 fails to address shareholder approval when a corporation sells all or substantially all of its assets through a *partially owned* subsidiary. This Comment suggests that Section 271 contains a loophole through which a corporation could disenfranchise shareholders in a major corporate decision, and it provides a theoretical example of how the loophole might work in practice. This Comment ultimately argues that the Delaware legislature should review and amend Section 271 to close the loophole and to provide needed predictability for courts and corporations alike.

AUTHOR—J.D., Northwestern University School of Law, 2014; B.A., Yale University, 2009. Many thanks to Professor Karl Lutz for his indispensable guidance, wisdom, and humor, especially during the writing of this Comment. Special thanks to the editors of the *Northwestern University Law Review*, who have spent countless hours helping me refine this Comment and to whom I owe both my deepest gratitude and, undoubtedly, a tremendous amount of coffee. Finally, my deepest thanks and love to my parents, David and Lyssa, and to my brothers, Carter and Graham, for their incredible love, support, and encouragement.

NORTHWESTERN UNIVERSITY LAW REVIEW

INTRODUCTION 1452

I. DELAWARE’S CORPORATE LAW JURISPRUDENCE 1455

 A. *The Plain Meaning Rule and the DGCL*..... 1456

 B. *Respect for Corporate Autonomy and Private Ordering* 1459

 C. *Judicial Deference to Legislative Remedy*..... 1463

II. SECTION 271’S APPLICATION IN CORPORATE TRANSACTIONS..... 1466

 A. *The Evolution of Section 271*..... 1467

 B. *Hypothetical Asset Sale Using Section 271’s Loophole*..... 1471

III. SHOULD SECTION 271 BE AMENDED? RAMIFICATIONS FOR CORPORATIONS,
 SHAREHOLDERS, AND THE FUTURE OF THE DGCL..... 1476

 A. *Section 271 Reinforces Corporate Efficiency and Private Ordering* 1476

 B. *Section 271 Undermines Shareholder Protection*..... 1480

 C. *The Legislature Should Reexamine and Amend Section 271* 1482

CONCLUSION 1484

INTRODUCTION

Section 271 of the Delaware General Corporation Law (DGCL) governs a corporation’s sale of its assets and the shareholder approval necessary to do so.¹ In 2005, the Delaware legislature amended Section 271 to strengthen shareholder protection when a corporation sells all or substantially all of its assets.² The move came in response to the Delaware Court of Chancery’s decision in *Hollinger Inc. v. Hollinger International, Inc.*,³ where the court recognized an opportunity for shareholder disenfranchisement in Section 271 when a parent corporation sold all or substantially all of its assets through a wholly owned subsidiary.⁴ Prior to 2005, a parent corporation could avoid a shareholder vote if it sold a significant amount of its assets—enough to effectuate a major corporate change—as long as the assets nominally belonged to the parent corporation’s wholly owned subsidiary.⁵ After *Hollinger* and the 2005 amendment to Section 271, a parent corporation must treat the assets of its

¹ DEL. CODE ANN. tit. 8, § 271 (2011).

² See Robert K. Clagg Jr., Comment, *An “Easily Side-Stepped” and “Largely Hortatory” Gesture?: Examining the 2005 Amendment to Section 271 of the DGCL*, 58 EMORY L.J. 1305, 1305 (2009).

³ See *id.*

⁴ See 858 A.2d 342, 374 (Del. Ch. 2004).

⁵ See *id.* at 373–74; see also Act of July 4, 1985, ch. 127, sec. 9, § 271, 65 Del. Laws 224, 225; DEL. CODE ANN. tit. 8, § 271 (2001) (failing to address the definition of “subsidiary,” which was clarified in Section 271’s 2005 amendment).

wholly owned subsidiary as its own,⁶ which, at least for the parent corporation's shareholders, positively changed the way parent corporations had to structure transactions.⁷

The 2005 amendment to Section 271 represented a substantial and beneficial change to the DGCL that protected both shareholders and corporations. By requiring shareholder approval when a corporation sold all of its assets through its wholly owned subsidiary, Section 271 provides shareholders with an important safeguard against disenfranchisement and gives parent corporations a defense against shareholder suits⁸: by following Section 271's specific requirements, a parent corporation can rest assured that it has a strong defense that it acted appropriately in an asset sale. The amendment also adheres to Delaware's philosophy that the board of directors' primary goal should be to maximize shareholder wealth.⁹ By sculpting a legal regime requiring methodical corporate decisions, Delaware has allowed corporate shareholders to be more confident about a corporation's ability to honestly increase shareholder value.¹⁰

Nevertheless, in drafting the 2005 amendment to Section 271, the Delaware legislature did not insert language addressing a scenario in which a parent corporation attempted to sell all or substantially all of its assets through a partially owned subsidiary.¹¹ The absence of specific language thus appears to create a unique opportunity for corporations to circumvent Section 271: A parent corporation could place all or substantially all of the consolidated corporate enterprise's assets into a partially owned subsidiary and then could have the partially owned subsidiary's board of directors sell the assets without approval from the parent corporation's shareholders. In

⁶ The Delaware legislature amended Section 271 to include language specifically designating that "the property and assets of the [parent] corporation include the property and assets of any subsidiary of the [parent] corporation." Act of May 17, 2005, ch. 30, sec. 28, § 271, 75 Del. Laws 21, 24. "[S]ubsiary" was defined as "any entity wholly-owned and controlled, directly or indirectly, by the [parent] corporation." *Id.*

⁷ See Clagg, *supra* note 2, at 1307 (noting that Section 271's 2005 amendment forced corporations to structure subsidiary asset sales in a way that gave shareholders more protection).

⁸ See *id.* at 1307–08.

⁹ See, e.g., Stephen M. Bainbridge, *UNOCAL at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 778 (2006) ("[T]he law clearly establishes shareholder wealth maximization as one of the default rights of shareholders . . ."); Brian M. McCall, *The Corporation as Imperfect Society*, 36 DEL. J. CORP. L. 509, 511 (2011) ("Conceptualizing corporate law as an area of law facilitating private ordering has led to the entrenchment of the principle of shareholder wealth maximization. Corporations exist to maximize shareholder wealth.").

¹⁰ See Adam Matthew Kay, Note, *Boardroom Roulette—A Reflective Look at International Goals, Failures, Crises and Remedies in the Field of Corporate Governance*, 19 MICH. ST. J. INT'L L. 449, 451–52 (2011) ("Courts have commonly recognized that corporations are organized and continued primarily for the profit of the stockholders.").

¹¹ Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1778 (2006) ("[The 2005 amendment to Section 271] did not, however, resolve the treatment of asset transfers to or by subsidiaries that are less than 'wholly owned,' nor did it attempt to define the terms 'owned' or 'controlled.'").

this way, the parent corporation could effect a fundamental corporate change¹² while still avoiding the onerous shareholder approval process. This loophole has potentially significant ramifications. On the one hand, by avoiding the arduous task of procuring shareholder approval,¹³ parent corporations may benefit from reduced transaction costs and added flexibility to pursue other business ventures. On the other hand, shareholders of parent corporations potentially could be exposed to notable risk because the shareholder protection improved by Section 271's 2005 amendment may be effectively neutered.¹⁴

Although some scholarship has been devoted to the ramifications of the 2005 amendment to Section 271, including the use of another DGCL provision as a workaround to Section 271,¹⁵ scant consideration has been

¹² A sale of all or substantially all of a corporation's assets is considered a "fundamental corporate change," which necessarily triggers a shareholder vote. See *Gimbel v. Signal Cos.*, 316 A.2d 599, 605–06 (Del. Ch. 1974) ("If the sale is of assets quantitatively vital to the operation of the corporation and . . . substantially affects the existence and purpose of the corporation, then it is beyond the power of the Board of Directors."), *aff'd*, 316 A.2d 619 (Del. 1974). There has been significant debate over what constitutes "all or substantially all" assets for the purposes of triggering a shareholder vote. See, e.g., *Hollinger Inc. v. Hollinger Int'l, Inc.*, 858 A.2d 342, 384–85 (Del. Ch. 2004) (using a qualitative determination to find that sale of assets was not "[all or] substantially all" because it did not "strike at [the seller's] heart or soul"); *Katz v. Bregman*, 431 A.2d 1274, 1276 (Del. Ch. 1981) (holding that sale of 51% of company's assets was "[all or] substantially all" given a quantitative and qualitative analysis); Donald A. Bussard, "All or Substantially All" the Assets Under Section 271, in 1 BALOTTI AND FINKELSTEIN'S DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 10.2 (R. Franklin Balotti & Jesse A. Finkelstein eds., 2014), available at Westlaw DELCBO ("The question most frequently encountered under Section 271 of the [DGCL] is whether a given transaction constitutes the sale of 'all or substantially all' within the meaning of Section 271."). This Comment does not deal with the ambiguity of "all or substantially all." Rather, this Comment limits discussion of Section 271 to scenarios in which a parent corporation is assumed to be selling all or substantially all of its assets.

¹³ Shareholder approval, even for a relatively straightforward corporate transaction like a tender offer made to a target corporation's shareholders, typically takes eight to ten weeks. *Private vs. Public Deals*, MACABACUS, <http://www.macabacus.com/mechanics/private-vs-public> (last visited Nov. 5, 2012).

¹⁴ See Clagg, *supra* note 2, at 1307 (pointing out that the Delaware legislature amended Section 271 to create greater shareholder protection).

¹⁵ See, e.g., *id.* at 1308–09 (exploring the ability of corporations to use DGCL Section 251 as a way around shareholder vote requirement in "Cash-Out Merger" situations, where a parent corporation places assets in a subsidiary that then engages in a cash-for-stock merger with a buyer or a buyer's subsidiary); Mark A. Morton & Michael K. Reilly, *Clarity or Confusion: The 2005 Amendment to Section 271 of the Delaware General Corporation Law*, 10 DEAL POINTS (A.B.A. Comm. on Negotiated Acquisitions, Chi., Ill.), Fall 2005, at 2 (examining whether a parent shareholder vote should be triggered when a parent corporation sells or drops down all of its assets to its wholly owned subsidiary); John J. Paschetto, *Statutory Clarification Regarding Sales of All or Substantially All Assets of a Delaware Corporation*, DEL. TRANSACTIONAL & CORP. L. UPDATE (Young Conway Stargatt & Taylor, LLP, Wilmington, Del.), Spring 2006, at 3, available at <http://www.youngconaway.com/files/Publication/50d987ea-3925-4d74-80c7-969b5e7e150d/Presentation/PublicationAttachment/395abd0d-b746-400a-8875-99c4230d6e3f/spring2006.pdf> (noting arguments for and against parent shareholder approval when selling all of a consolidated corporation's assets through a wholly owned subsidiary).

given to asset sales through a partially owned subsidiary. This Comment examines how Delaware's unique judicial and legislative approaches could allow exploitation of Section 271's loophole, what a corporate transaction utilizing the loophole might look like in practice, and the loophole's benefits and drawbacks. In Part I, this Comment explores Delaware's judicial philosophy toward interpreting and applying the DGCL, which is one of strict adherence to the statute's plain language. Part II examines the text and legislative history of Section 271, which ostensibly condone an asset sale through a partially-owned subsidiary. This Comment then applies Section 271's loophole to a hypothetical asset sale. In Part III, this Comment discusses the ramifications of Section 271's loophole for corporations, shareholders, and the future of the DGCL. This Comment argues that, as it currently exists, Section 271 does not comport with the policy rationale behind the 2005 amendment of providing adequate shareholder protection. Therefore, it should be amended. Although other states provide less shareholder protection with respect to subsidiary asset sales,¹⁶ the Delaware legislature has shown a preference for shareholder protection both when corporations attempt to sell all or substantially all of their assets and in the spirit of the DGCL as a whole.¹⁷ As it stands, Section 271 leaves shareholders on shaky, uncertain ground.

I. DELAWARE'S CORPORATE LAW JURISPRUDENCE

In 1899, the Delaware Constitutional Convention enacted the state's first general incorporation law, which underwent numerous revisions before reaching its modern iteration in 1967.¹⁸ Upon the DGCL's adoption, the Delaware Court of Chancery, created as a court of law and equity long before the enactment of the DGCL, was primarily tasked with interpreting and applying the DGCL to a range of corporate disputes.¹⁹ The Court of Chancery has carved a niche for itself as this nation's most influential court in adjudicating corporate disputes²⁰ in part because it hears so many of them—over 1000 in 2011, a number that appears to be on the rise²¹—and in

¹⁶ See *infra* Part III.C.

¹⁷ See discussion *infra* Part II.A.

¹⁸ For an in-depth analysis of the history and development of the Delaware General Corporation Law, see S. Samuel Arshat, *A History of Delaware Corporation Law*, 1 DEL. J. CORP. L. 1 (1976) (tracking the legislative and judicial influence on the formation of Delaware's corporate law).

¹⁹ See William T. Quillen & Michael Hanrahan, *A Short History of the Delaware Court of Chancery: 1792–1992*, DEL. ST. CTS. (1993), <http://courts.delaware.gov/chancery/history.stm> (last visited Jan. 13, 2014).

²⁰ See Stephen J. Massey, *Chancellor Allen's Jurisprudence and the Theory of Corporate Law*, 17 DEL. J. CORP. L. 683, 685 (1992) ("While the Delaware Court of Chancery may not be widely known, its significance in matters of corporate law has been said to surpass that of the United States Supreme Court.").

²¹ Between 2010 and 2011, there was a 12.2% increase in the number of civil actions filed in the Court of Chancery (931 in 2010 and 1045 in 2011). See COURT OF CHANCERY, STATE OF DELAWARE,

part because the court is unencumbered by jurisdiction over other legal matters,²² permitting the court to develop special expertise in corporation law.

The Delaware Court of Chancery has developed a straightforward interpretive approach to the DGCL. Specifically, the court reads and applies the DGCL as it is written unless there is obvious statutory ambiguity.²³ The court's adherence to the DGCL's plain language is due in large part to the Delaware legislature's respect for corporate autonomy.²⁴ That is, provided the DGCL does not clearly prescribe a particular corporate action, a board is bound only to govern a corporation according to its articles of incorporation and bylaws.²⁵ Furthermore, the judiciary is notably reluctant to create a large body of common law when the DGCL is ambiguous; rather, the courts defer to the legislature to resolve statutory ambiguity.²⁶ Within this judicial and legislative framework, then, deficiencies in the DGCL—such as the loophole in Section 271—are noted by the courts and left to the Delaware legislature to amend.

A. *The Plain Meaning Rule and the DGCL*

Delaware courts' straightforward interpretative method is hardly uncommon. All United States courts generally apply a statute's plain language in the absence of ambiguity.²⁷ As the Fourth Circuit noted in *In re*

2011 ANNUAL REPORT STATISTICAL INFORMATION (2011), available at <http://courts.delaware.gov/AOC/AnnualReports/FY11/CourtofChancery2011.pdf>.

²² See Massey, *supra* note 20, at 704–05.

²³ See, e.g., Alfieri v. Martelli, 647 A.2d 52, 54 (Del. 1994) (“In seeking to ascertain legislative intent, the Delaware courts utilize the plain meaning rule.” (citing *In re Adoption of Swanson*, 623 A.2d 1095, 1096–97 (Del. 1993)); *State v. Cephas*, 637 A.2d 20, 23 (Del. 1994) (“Where the intent of the legislature is clearly reflected by unambiguous language in the statute, the language itself controls.” (quoting *Spielberg v. State*, 558 A.2d 291, 293 (Del. 1989))); see also *infra* Part I.A (discussing the plain meaning rule).

²⁴ See, e.g., *Rodgers v. Erickson Air-Crane Co.*, 740 A.2d 508, 512 (Del. Super. Ct. 1999) (“In divining legislative intent, it is said that where the statute as a whole is unambiguous, the Court's role is limited to giving effect to the literal meaning of the words used.” (citing *Coastal Barge Corp. v. Coastal Zone Indus. Control Bd.*, 492 A.2d 1242, 1246 (1985)); *Hollinger Int'l Inc. v. Black*, 844 A.2d 1022, 1078 (Del. Ch. 2004) (“The DGCL is *intentionally designed* to provide directors and stockholders with flexible authority, permitting great discretion for private ordering and adaptation.” (emphasis added)); see also *infra* notes 77–78 and accompanying text.

²⁵ As is discussed *infra*, the limits to this freedom mostly come through judicial enforcement of fiduciary duties. See *infra* Part I.B.

²⁶ See *infra* Part I.C; see also Arshat, *supra* note 18, at 21 (noting that the DGCL's amendment process has “added to [the DGCL's] clarity, fairness and flexibility,” and that “[i]f a provision in the [DGCL] has been shown to be ambiguous, the [legislative committee tasked with evaluating the DGCL] has attempted to remove the ambiguity”).

²⁷ See, e.g., *Caraco Pharm. Labs., Ltd. v. Novo Nordisk A/S*, 132 S. Ct. 1670, 1680 (2012), (stating that “all such inquiries [into the meaning of a statute] must begin[] with the language of the statute itself” (quoting *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989))); *Smith v. Zachary*, 255 F.3d 446, 448 (7th Cir. 2001) (“The plain meaning rule is applicable when the statutory language is

Sunterra Corp., “[A] court’s analysis must end with the statute’s plain language.”²⁸ Although the “plain-meaning rule”—as it is called by Delaware courts—is “rather an axiom of experience than a rule of law, and does not preclude consideration of persuasive evidence if it exists,”²⁹ the principle remains a crucial tenet of Delaware’s corporate law jurisprudence.

The significance of the plain meaning rule is due in large part to the rigorous amendment process undertaken by the Council of the Corporation Law Section of the Delaware State Bar Association.³⁰ The Council acts on behalf of the Delaware General Assembly, and all proposed amendments to the DGCL are subject to a vote by the General Assembly.³¹ The Council carefully shapes the DGCL with the understanding that any amendments or modifications to the statute should improve Delaware’s hospitable corporate environment.³² The focus on a favorable state for incorporation, in turn, fosters recognition among judges that jurisprudential consistency (i.e., by applying the DGCL uniformly and predictably) is crucial to attracting tax-paying businesses.³³ Professor Lawrence Hamermesh writes that Delaware judges, attorneys, and Council members regard the emphasis on a stable legal regime as a primary impetus for changing corporate law through amending the DGCL, rather than through common law development:

Delaware lawyers and judges consistently and consciously articulate reasons for this high degree of stability [in the DGCL]. Most prominent is a pervasive belief that the system of corporate law supplied by Delaware has worked pretty well, and that change should not be made unless it is apparent that there will be a significant benefit from it without any countervailing disruption. In all of the Council meetings I have attended, this caution is the heuristic that is far and away the most commonly invoked in considering potential changes to the corporation law.³⁴

clear, unambiguous, and not controlled by other parts of the act or other acts on the same subject.”); *CBS Inc. v. PrimeTime 24 Joint Venture*, 245 F.3d 1217, 1222 (11th Cir. 2001) (adhering to the plain meaning rule to avoid looking to legislative intent or other extrinsic evidence in statutory interpretation).

²⁸ 361 F.3d 257, 265 (4th Cir. 2004) (noting that “unless there is some ambiguity in the language of a statute, a court’s analysis must end with the statute’s plain language” (quoting *Hillman v. IRS*, 263 F.3d 338, 342 (4th Cir. 2001))).

²⁹ *Watt v. Alaska*, 451 U.S. 259, 266 (1981) (quoting *Bos. Sand & Gravel Co. v. United States*, 278 U.S. 41, 48 (1928)).

³⁰ See Hamermesh, *supra* note 11, at 1755–59; see also Arsht, *supra* note 18, *passim* (detailing the development of the DGCL and its amendments through the years).

³¹ See Hamermesh, *supra* note 11, at 1755. When this Comment references actions by the Delaware legislature, it refers to initial action by the Council and subsequent approval by the General Assembly.

³² See *id.* at 1772.

³³ See *id.* at 1772 & n.100, 1774–75.

³⁴ See *id.* at 1772.

The Delaware judiciary's use of the plain meaning rule thus makes the DGCL's stability self-fulfilling: To be faithful to the legislative intent inherent in the DGCL, Delaware courts adjudicate many disputes by applying the DGCL's plain language, thereby reducing the number of anomalous litigation results potentially used as a basis for legislative amendment to the DGCL.³⁵

Delaware courts have relied upon the plain meaning rule in a wide range of commercial disputes, including how to best apply the DGCL in disagreements over payment of litigation expenses,³⁶ the rights of shareholders to inspect corporate books,³⁷ the ability for directors to incorporate poison pill provisions in a shareholder rights plan,³⁸ and shareholder appraisal rights when a market exception applies.³⁹ Underlying each application of the plain meaning rule is the courts' desire for legal consistency, which helps to provide clear guidelines for corporate governance and does not "upset ongoing corporate decisionmaking or the public markets."⁴⁰ Perhaps the most important corollary of the courts' interpretative approach is a notable degree of respect for corporate autonomy. Put simply, in the absence of specific language in the DGCL mandating certain corporate actions, corporations are given wide latitude to govern themselves according to their articles of incorporation and bylaws.⁴¹

³⁵ See *infra* Part I.C; see also, e.g., *CML V, L.L.C. v. Bax*, 28 A.3d 1037, 1041 (Del. 2011) ("We also ascribe a purpose to the General Assembly's use of particular statutory language and construe it against surplusage if reasonably possible."); *Crown EMAK Partners v. Kurz*, 992 A.2d 377, 398 (Del. 2010) (holding that the Court of Chancery's interpretation of DGCL Section 219 was incorrect, and that any ambiguity in the section should be cured by the legislature because "[t]he DGCL is a comprehensive and carefully crafted statutory scheme that is periodically reviewed by the General Assembly"). The General Assembly—and thus the Council of Corporation Law Section of the Delaware State Bar Association—reviews potential DGCL amendments approximately once per year. See Hamermesh, *supra* note 11, at 1756 (detailing the Council's yearly legislation proposal and subsequent consideration schedule).

³⁶ *Reddy v. Elec. Data Sys. Corp.*, No. CIV.A. 19467, 2002 WL 1358761, at *4 (Del. Ch. June 18, 2002) (holding that plain meaning of DGCL Section 145 required corporation to advance funds to former employee).

³⁷ *Scattered Corp. v. Chi. Stock Exch., Inc.*, 671 A.2d 874, 877–78 (Del. Ch. 1994) (holding that absence of plain language in DGCL Section 220 pertaining to inspection rights of members of nonstock corporations, when read in harmony with related DGCL provisions, gave no general inspection rights).

³⁸ *Hollinger Int'l, Inc. v. Black*, 844 A.2d 1022, 1083 (Del. Ch. 2004) (holding that board's incorporation of poison pill provision in shareholder rights plan comported with provisions of the DGCL and was therefore acceptable, even though it discriminated against a shareholder).

³⁹ *Klotz v. Warner Commc'ns, Inc.*, 674 A.2d 878, 881 (Del. 1995) (holding that shareholder had no right to appraisal under DGCL Section 262 because shares fell under the general market exception, even though written consent for merger was given).

⁴⁰ See Edward B. Micheletti & T. Victor Clark, *Recent Developments in Corporate Law*, 8 DEL. L. REV. 17, 17–19 (2005) (arguing that the Court of Chancery's decisions demonstrate its commitment to providing guidelines to help the corporate bar "chart a course . . . toward the best corporate practices").

⁴¹ See, e.g., *Centaur Partners, IV v. Nat'l Intergroup, Inc.*, 582 A.2d 923, 927 (Del. 1990) ("The Delaware General Corporation Law affords considerable flexibility in the construction mechanisms for corporate governance and control."); *Black*, 844 A.2d at 1078 ("The DGCL is intentionally designed to

B. Respect for Corporate Autonomy and Private Ordering

Delaware corporate law has long recognized a board of directors's ability to steer corporate behavior according to the corporation's articles of incorporation and bylaws⁴²—often called “private ordering”⁴³—provided the corporate articles and bylaws do not conflict with the DGCL or another statute.⁴⁴ Among other rules, Subchapter 1 of the DGCL details the requirements for incorporation,⁴⁵ the powers vested in the incorporators,⁴⁶ and the corporate bylaw requirements.⁴⁷ Sections 121 and 122 of the DGCL describe the general and specific powers given to corporations under law. Whereas Section 122 sets forth seventeen specific corporate powers,⁴⁸ Section 121(a) vests corporations with broad general power.⁴⁹

More importantly, Section 102 extensively outlines requirements and suggestions for a corporation's articles.⁵⁰ Section 102 sets forth only six required provisions in a corporation's articles: The name of the corporation,⁵¹ the corporation's address,⁵² the nature of the corporation's business,⁵³ the classes of stock issued by the corporation,⁵⁴ the names and addresses of the incorporators,⁵⁵ and the names and addresses of the corporation's first board of directors.⁵⁶ The rest of Section 102 permits—

provide directors and stockholders with flexible authority, permitting great discretion for private ordering and adaptation.”); *see also* Kay, *supra* note 10 (“Corporations choose to incorporate in Delaware because of the flexibility allowed by the DGCL.”).

⁴² Micheletti & Clark, *supra* note 40, at 35 (“Delaware's corporate statute is widely regarded as the most flexible in the nation because it leaves the parties to the corporate contract (managers and stockholders) with great leeway to structure their relations, subject to relatively loose statutory constraints and to the policing of director misconduct through equitable review” (quoting *Jones Apparel Grp., Inc. v. Maxwell Shoe Co.*, 883 A.2d 837, 845 (Del. Ch. 2004))).

⁴³ *See* Hamermesh, *supra* note 11, at 1782–83; Edward P. Welch & Robert S. Saunders, *Freedom and Its Limits in the Delaware General Corporation Law*, 33 DEL. J. CORP. L. 845, 847 & n.10 (2008).

⁴⁴ *See* Welch & Saunders, *supra* note 43, *passim* (discussing the limitations and freedoms in the DGCL with respect to corporate autonomy and corporate reliance on general principles of contract law).

⁴⁵ *See* DEL. CODE ANN. tit. 8, § 101 (2011).

⁴⁶ *See id.*

⁴⁷ *See id.* § 109.

⁴⁸ *See id.* § 122.

⁴⁹ *Id.* § 121(a). Section 121(b) reaffirms the necessity for corporations to adhere to the express language of the DGCL: “Every corporation shall be governed by the provisions and be subject to the restrictions and liabilities contained in this chapter.” *Id.* § 121(b).

⁵⁰ *Id.* § 102. Section 102 requires, through the use of “shall,” that certain elements be included in a corporation's articles. *Id.* However, most of Section 102's subsections, through the use of “may,” are permissive and allow for significant flexibility in the structure of the corporate articles. *Id.*

⁵¹ *Id.* § 102(a)(1).

⁵² *Id.* § 102(a)(2).

⁵³ *Id.* § 102(a)(3).

⁵⁴ *Id.* § 102(a)(4).

⁵⁵ *Id.* § 102(a)(5).

⁵⁶ *Id.* § 102(a)(6).

but does not require—certain information to be included in a corporation’s articles. Significantly, Section 102(b)(1) allows a corporation to include a provision “for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders,” so long as the provision does not conflict with Delaware law.⁵⁷ Section 102 thus permits boards to decide how a corporation will be structured and governed.⁵⁸

DGCL Section 109(b) also sets forth a corporation’s ability to include in its corporate articles any bylaws “relating to the business of the corporation, the conduct of its affairs, and its rights or powers or the rights or powers of its stockholders, directors, officers or employees.”⁵⁹ The power to institute, revise, or repeal corporate bylaws is vested in both the corporate directors and the shareholders, which ostensibly provides a check on directors who hope to use the bylaws to run a corporation however they choose.⁶⁰

Nevertheless, DGCL Section 141 appears to override Section 109’s shareholder protections and, as such, has been the subject of some scholarly debate.⁶¹ Section 141 gives meaning to a corporation’s articles and bylaws by designating the corporation’s board of directors as the manager of its business and affairs.⁶² As a result, Section 141 provides a way for a corporate board to insulate itself from shareholder suits for breaches of fiduciary duties because the board can claim that a particular corporate action was within a board’s purview as the corporate manager.⁶³ In this way, the DGCL at least nominally allows a corporate board to structure its articles and bylaws to give itself significant latitude to manage the corporation as it sees fit, without shareholder oversight.⁶⁴

Corporate governance in Delaware, therefore, principally is underpinned by freedom of contract principles; the articles of incorporation are considered a bargained-for contract between the corporation and its

⁵⁷ *Id.* § 102(b)(1).

⁵⁸ *Id.*; see also Elizabeth A. Nowicki, *Not in Good Faith*, 60 SMU L. REV. 441, 452 (2007) (“[Section 102] . . . allows a business that is incorporated in Delaware to fully insulate its directors against personal liability for any fiduciary duty breach other than those in the limited categories of breach of the duty of loyalty and acts or omissions ‘not in good faith.’”).

⁵⁹ § 109(b).

⁶⁰ See Brett H. McDonnell, *Bylaw Reforms for Delaware’s Corporation Law*, 33 DEL. J. CORP. L. 651, 659–60 (2008).

⁶¹ See *id.* (noting the inherent conflict between Section 109 and Section 141, and the need for more clarification on the point).

⁶² § 141(a).

⁶³ See McDonnell, *supra* note 60, at 665 (proposing that Section 141 be amended to allow shareholders to limit corporate board discretion, which would dissolve any conflict between Section 109 and Section 141, and would also continue to shield a board from breach of fiduciary duty suits).

⁶⁴ See §§ 101, 102, 109, 121–122; D. Gordon Smith et al., *Private Ordering with Shareholder Bylaws*, 80 FORDHAM L. REV. 125, 170 (2011) (noting that Delaware “continue[s] to rely on ‘director primacy’ as a foundational principle of corporate governance”).

shareholders for which the DGCL provides “default” rules.⁶⁵ The watershed case *Sterling v. Mayflower Hotel Corp.* illustrates this point.⁶⁶ There, the Delaware Supreme Court held that the terms of a proposed merger agreement between Mayflower Hotels and Hilton Hotels were not unfair to minority shareholders, even though the quorum of directors approving the merger was comprised of Hilton appointees. Mayflower Hotel’s articles of incorporation provided that “fraud being absent, a transaction with another corporation is not invalidated by reason of the existence of interlocking directors or directors otherwise interested in such other corporation; and further provides that any such director may be counted toward a quorum.”⁶⁷ The court’s holding centered on “the right [of a corporation] to include in a certificate of incorporation any provision deemed appropriate for the conduct of the corporate affairs.”⁶⁸ Even though a clear conflict of interest existed, the court condoned the merger because Mayflower Hotel itself had said it was permissible.⁶⁹

Treating articles of incorporation and bylaws as bargained-for contracts between corporations and shareholders—with the DGCL providing default rules—emphasizes corporate efficiency and minimizes transaction costs.⁷⁰ By allowing corporations and shareholders “broad discretion to establish at the outset whatever terms for the organization, management, and finance of the corporation they believe will best serve the needs of the particular enterprise,”⁷¹ the DGCL encourages bargaining among parties to reach an optimal balance of rights and risks.⁷² For

⁶⁵ See Welch & Saunders, *supra* note 43, at 848 (“[T]he Delaware corporation statute has long embodied a structure of default rules that stockholders can bargain around by including contrary provisions in their certificate of incorporation.”); see also *Frankel v. Donovan*, 120 A.2d 311, 316 (Del. Ch. 1956) (“Charter provisions which facilitate corporate action and to which a stockholder assents by becoming a stockholder are normally upheld by the court unless they contravene a principle implicit in statutory or settled decisional law governing corporate management.”).

⁶⁶ See 93 A.2d 107, 116–17 (Del. 1952). Although *Mayflower Hotel* occurred before the modern DGCL was formally passed in 1967, some see it as the beginning of the Delaware judiciary’s application of freedom of contract principles to corporate governance. See Welch & Saunders, *supra* note 43, at 845–46.

⁶⁷ *Mayflower Hotel*, 93 A.2d at 117. The court cited and interpreted the express language in Article Thirteenth of Mayflower Hotel’s articles of incorporation. See *id.* at 117 & n.3.

⁶⁸ *Id.* at 117.

⁶⁹ *Id.* at 117–18.

⁷⁰ See Welch & Saunders, *supra* note 43, at 848 (“[C]orporation statutes should supply efficient default rules that minimize transaction costs, while permitting parties to bargain for different rules if they wish.”).

⁷¹ *Id.*

⁷² Although the DGCL provides significant flexibility for corporations to govern themselves, this freedom is curtailed at the point where the legislature perceives opportunities for abuse. Professor Lawrence Hamermesh describes the rejection of a proposed amendment to enhance the flexibility of Section 102(d) because it would have given corporate boards the unilateral ability to “eliminate an otherwise bargained-for element of control on the part of one or more stockholders.” See Hamermesh, *supra* note 11, at 1783–84.

example, Section 102(b)(7) allows corporations to limit or eliminate the personal monetary liability of directors for the breach of the fiduciary duty of care.⁷³ The DGCL inheres some shareholder risk, and it gives corporate directors the lion's share of control over the corporation,⁷⁴ but Delaware implicitly adopts the view that shareholders accept this risk in exchange for greater efficiency and, presumably, greater profits.⁷⁵ Still, some scholars have suggested that a more shareholder-centric approach to corporate governance would buffer the DGCL's inherent risk and would give shareholders greater control over the corporations they nominally own.⁷⁶

The flexibility provided to Delaware corporations and shareholders to efficiently manage themselves inside—and sometimes outside—the framework of the DGCL nonetheless appears to be a permanent fixture of Delaware corporate law. Indeed, Professor Hamermesh describes the private ordering as one of the Delaware legislature's primary concerns when it amends the DGCL, and proposed amendments or rules that do not upset this private ordering are “almost presumptively approved.”⁷⁷ Delaware also benefits tremendously from this emphasis on private ordering;⁷⁸ corporate franchise taxes typically constitute well over 20% of Delaware's annual budget.⁷⁹

Nevertheless, tension exists between corporate autonomy and shareholder protection.⁸⁰ Despite the DGCL's permissiveness, the Delaware legislature is nevertheless committed to ensuring that the balance of power between management and shareholders under the DGCL does not

⁷³ DEL. CODE ANN. tit. 8, § 102(b)(7) (2011).

⁷⁴ See Smith et al., *supra* note 64, at 130 (noting that the Delaware General Assembly continues to “rely on a board-centered view of corporate governance generally”).

⁷⁵ See Welch & Saunders, *supra* note 43, at 861 (“[T]he market . . . can be relied upon to incentivize incorporators to draft terms that maximize the aggregate wealth of the incorporators and stockholders together.”); see also Hamermesh, *supra* note 11, at 1784 (observing that the Council views the DGCL under the initial assumption that governing terms—even ones potentially open to abuse—are “understood, appropriately priced, and voluntarily embraced”).

⁷⁶ See, e.g., Christopher M. Bruner, *The Enduring Ambivalence of Corporate Law*, 59 ALA. L. REV. 1385, 1405 (2008) (“Shareholder-centric models of corporate governance have gained substantial traction in the new millennium, with calls for accountability to shareholders animated principally by dissatisfaction with perceived shirking and extraction of private benefits by insiders . . .”); McDonnell, *supra* note 60, at 670–72 (arguing that DGCL Section 109 should be amended to give greater authority to shareholders to sculpt a corporation's bylaws without having to worry about a board unilaterally repealing them).

⁷⁷ Hamermesh, *supra* note 11, at 1783.

⁷⁸ See Demetrios G. Kaouris, *Is Delaware Still a Haven for Incorporation?*, 20 DEL. J. CORP. L. 965, 966 (1995) (footnotes omitted) (“Due to potentially large revenues that states can generate through corporate franchise taxes, states compete with each other to create a corporate code that best matches the needs of corporations. Therefore, the states with the most developed and responsive corporate law receive the largest revenues.”).

⁷⁹ Lawrence Hamermesh, *How We Make Law in Delaware, and What to Expect from Us in the Future*, 2 J. BUS. & TECH. L. 409, 411 (2007).

⁸⁰ See discussion *infra* Part III.B.

shift significantly in favor of management.⁸¹ Potential corporate opportunism is most often checked by judicial enforcement of fiduciary duties.⁸² Still, the legislature amends the DGCL when ambiguities in the DGCL become apparent and require clarification.⁸³ As Professor Hamermesh writes, “[T]he Council and the Delaware General Assembly are often responsive when the courts themselves report matters that merit legislative attention.”⁸⁴

C. Judicial Deference to Legislative Remedy

The Delaware legislature actively works to promote a favorable business environment by routinely considering and revising the DGCL, but it also responds to judicial concern about particular DGCL provisions that are ripe for corporate overreach or opportunism.⁸⁵ The legislature “prefer[s] that the courts be the first responders to controversies in applying Delaware corporate law.”⁸⁶ Changes to the DGCL therefore frequently result from judicial inability to clearly ascertain the legislative intent behind an ambiguous DGCL provision, manifested both in dicta and inconsistent holdings.⁸⁷ Such judicial inconsistency strikes at the core of the DGCL’s underlying goal—promoting legal predictability as an attraction for corporations⁸⁸—so the typically reluctant General Assembly steps in to clarify and restore predictability to a DGCL provision. Consequently, there

⁸¹ Hamermesh, *supra* note 11, at 1763–64 (“[T]oday’s drafters of the DGCL do not devote an iota of conscious effort to make that statute more friendly to management and less protective of stockholders.”).

⁸² See, e.g., *Gantler v. Stephens*, 965 A.2d 695, 708–09 (Del. 2009); *Malone v. Brincat*, 722 A.2d 5, 9–10 (Del. 1998); *Broz v. Cellular Info. Sys., Inc.*, 673 A.2d 148, 157 (Del. 1995); Leo E. Strine Jr., *If Corporate Action Is Lawful, Presumably There Are Circumstances in Which It Is Equitable to Take That Action: The Implicit Corollary to the Rule of Schnell v. Chris-Craft*, 60 BUS. LAW. 877, 880 (2005) (observing that Delaware’s technique of assessing whether a board breached its fiduciary duties in a corporate action operates by the maxim that “simply because [an] action is statutorily or contractually lawful, does not mean that it is equitable”).

⁸³ Hamermesh, *supra* note 11, at 1773 (observing that the Delaware legislature decided not to take action on an ambiguous DGCL provision, instead opting for a common law approach by waiting to see if the Delaware judiciary struggled to apply it before determining whether a legislative response was needed).

⁸⁴ *Id.* at 1781.

⁸⁵ See *id.*

⁸⁶ *Id.* at 1782.

⁸⁷ See, e.g., *Hollinger Inc. v. Hollinger Int’l, Inc.*, 858 A.2d 342, 349 (Del. Ch. 2004) (deferring to legislative remedy on the question of whether Section 271’s ambiguity permits asset sales through subsidiaries without shareholder approval); *Jones Apparel Grp., Inc. v. Maxwell Shoe Co.*, 883 A.2d 837, 846–47 (Del. Ch. 2004) (“Given that the DGCL . . . is not perfectly consistent, this counsels in favor of approaching decisions like this one with some modesty . . .”).

⁸⁸ See Rodman Ward Jr. & Erin Kelly, *Why Delaware Leads in the United States as a Corporate Domicile*, 9 DEL. LAW. 15, 16 (1991) [hereinafter *Why Delaware Leads*]; see also Hamermesh, *supra* note 11, at 1786 (explaining that certain amendments to the DGCL were “promoted with an awareness that they might enhance Delaware’s reputation and desirability as a choice of corporate domicile”).

is a notable lack of judge-made law adding to the DGCL's statutory regime.⁸⁹ As the Delaware Supreme Court stated in *Crown EMAK Partners, L.L.C. v. Kurz*, a convoluted case that dealt with the Court of Chancery's interpretation of "stock ledger" in DGCL Section 219:

[A] legislative cure [for the ambiguity present in Section 219] is preferable. The DGCL is a comprehensive and carefully crafted statutory scheme that is periodically reviewed by the General Assembly. . . . Any adjustment to the intricate scheme of which section 219 is but a part should be accomplished by the General Assembly through a coordinated amendment process.⁹⁰

To maintain consistency, the Court then declared "the Court of Chancery's interpretation of stock ledger . . . *obiter dictum* and without precedential effect."⁹¹

The Delaware judiciary does use common law precedent to shape how corporations are governed, but this body of precedent largely pertains to the clarification of fiduciary duties.⁹² Indeed, Delaware's fiduciary duty jurisprudence necessarily lends itself to common law evolution because the particular circumstances of director conduct, as well as the inherent tension between fiduciary standards and the business judgment rule,⁹³ are best evaluated on a case-by-case basis.⁹⁴ Especially with respect to application of the business judgment rule, the Delaware courts' fiduciary duty jurisprudence provides interesting insight into the level of deference given to corporate boards. Delaware courts view the business judgment rule as "a

⁸⁹ See Hamermesh, *supra* note 11, at 1784–86 & n.159.

⁹⁰ 992 A.2d 377, 398 (Del. 2010).

⁹¹ *Id.*

⁹² See Strine, *supra* note 82, at 879 ("In Delaware, . . . the continued importance of the common law of corporations is not the result of happenstance, but reflects a policy choice made by the Delaware General Assembly. That choice deliberately deploys Delaware's judiciary to guarantee the integrity of our corporate law through the articulation of common law principles of equitable behavior for corporate fiduciaries."); E. Norman Veasey with Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992–2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1413 (2005) ("The judicial articulation of fiduciary duty law in Delaware is constantly evolving and has developed over about eight or nine decades. It is the quintessential application of the common law process.").

⁹³ The business judgment rule is a legal presumption that a corporation's board of directors acted in good faith and in the best interests of the company. See Blake Rohrbacher, *The Business Judgment Rule*, in 1 BALOTTI AND FINKELSTEIN'S DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS, *supra* note 12, § 4.19. Fiduciary duties keep board members from acting against the shareholders' best interests, so the business judgment rule acts as a defense to a claim that a board has breached its fiduciary duties to shareholders. See, e.g., Hamermesh, *supra* note 11, at 1784–85 ("As long as the [Delaware] courts more or less sensibly call the balls and strikes—that is, remedy managerial behavior that unduly defeats reasonable expectations while blessing behavior that does not—the Council and the General Assembly can comfortably expand the realm of private flexibility in the DGCL.").

⁹⁴ See Jill E. Fisch, *The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters*, 68 U. CIN. L. REV. 1061, 1076 (2000) ("Delaware courts . . . apply the relevant legal standards in a fact and case specific manner.").

presumption that courts will not interfere with, or second guess, decision making by directors,” unless there is clear cause to do so.⁹⁵

It perhaps is demonstrative of Delaware courts’ reluctance to be proactive participants in corporate governance that, even in the realm of corporate law shaped almost exclusively by judicial review, the courts initially apply a doctrine of judicial abstention.⁹⁶ Although they possess considerable authority to shape the direction of corporate affairs, Delaware courts nonetheless are wary of interfering with the legislature’s exclusive purview.⁹⁷ The Delaware legislature and courts work symbiotically: “The legislature crafts the broad, largely flexible framework for private ordering of corporate affairs in the knowledge that the judiciary will protect such flexibility while applying equitable principles of fiduciary duty to rein in particularly opportunistic behavior that defeats the legitimate expectations of other corporate participants.”⁹⁸ In conjunction with its consistent application of the plain meaning rule⁹⁹ and its respect for corporate autonomy,¹⁰⁰ the Delaware courts’ role as “the first responders to controversies in applying Delaware corporate law” allows them to accurately determine which DGCL provisions are unduly ambiguous or susceptible to corporate opportunism;¹⁰¹ the General Assembly subsequently responds by amending the DGCL.¹⁰² In this way, the Delaware lawmaking process is decidedly more reactive than proactive.¹⁰³

⁹⁵ See Veasey with Di Guglielmo, *supra* note 92, at 1422.

⁹⁶ See *id.* However, some legal scholars believe that the Delaware courts’ typical deference to corporate boards under the business judgment rule is actually deteriorating. See William J. Carney & George B. Shepherd, *The Mystery of Delaware Law’s Continuing Success*, 2009 U. ILL. L. REV. 1, 12 (“The dominant phenomena present in recent Delaware judicial decisions are a loss of the courts’ faith in the good faith of directors and a significant erosion of the deference formerly granted under the business judgment rule.”).

⁹⁷ See, e.g., *Williams v. Geier*, 671 A.2d 1368, 1385 (Del. 1996) (refusing to “engraft . . . an exception to the statutory structure and authority” to provide plaintiff with ad hoc relief because doing so would have constituted “impermissible judicial legislation” (citing *Nixon v. Blackwell*, 626 A.2d 1366, 1379–81 (Del. 1993)); *Nixon*, 626 A.2d at 1377 (holding that a corporate practice was acceptable, despite disparate treatment of employee and nonemployee stockholders, because there was no legislation stating otherwise and unilateral adoption of an equitable rule by the court would “border on judicial legislation” (citing *Providence & Worcester Co. v. Baker*, 378 A.2d 121, 124 (Del. 1977))); *Gluricich v. Emtrol Corp.*, 449 A.2d 232, 238 (Del. 1982) (“The courts may not engraft upon a statute language which has been clearly excluded therefrom by the Legislature.” (citing *Wilmington Trust Co. v. Barry*, 338 A.2d 575, 578 (Del. Super. Ct. 1975), *aff’d*, 359 A.2d 664 (Del. 1976))).

⁹⁸ *Hamermesh*, *supra* note 11, at 1786.

⁹⁹ See *supra* Part I.A.

¹⁰⁰ See *supra* Part I.B.

¹⁰¹ See *Hamermesh*, *supra* note 11, at 1782.

¹⁰² See *id.* at 1781–82.

¹⁰³ See *id.* at 1782 (“[E]ven though the Council and the General Assembly are not passive participants in the lawmaking process in Delaware, they do—despite their attentiveness and willingness to act—overwhelmingly prefer to let corporate lawmaking occur without detailed regulatory prescription.”).

This approach has important ramifications for corporate governance and how corporate boards gauge the consistency with which Delaware courts will rule on a certain issue, including the open loophole in Section 271. As will be discussed below, Delaware's reactive approach seems to indicate that the loophole in Section 271 will not be closed—if it is at all—until it is exploited and the Delaware legislature is asked for a remedy.

II. SECTION 271'S APPLICATION IN CORPORATE TRANSACTIONS

Section 271 of the DGCL governs a corporation's sale, lease, or exchange of assets.¹⁰⁴ In relevant part, Section 271 requires approval by a majority of a corporation's outstanding shareholders¹⁰⁵ before the corporation can sell "all or substantially all" of its assets.¹⁰⁶ This required approval safeguards shareholders against a unilateral board decision that could effectively eviscerate a corporation.¹⁰⁷ This additional layer of protection ostensibly ensures that shareholders will retain a voice in fundamental corporate changes, which comports with other provisions of the DGCL requiring shareholder input.¹⁰⁸

Section 271 has fostered significant debate, culminating in the Delaware Court of Chancery's decision in *Hollinger Inc. v. Hollinger International, Inc.* and the legislature's subsequent 2005 amendment to Section 271. Indeed, Section 271's evolution, like that of many DGCL provisions, has been defined by judicial attempts to resolve statutory ambiguity¹⁰⁹ followed by responsive clarification by the Delaware legislature.¹¹⁰ In its current form, Section 271 offers substantial shareholder protection. A loophole remains, however, through which a corporate board could disenfranchise shareholders by entirely avoiding the majority

¹⁰⁴ DEL. CODE ANN. tit. 8, § 271 (2011).

¹⁰⁵ Outstanding shareholders hold those shares issued to the public by a corporation, known as outstanding stock. "[O]utstanding stock" is defined as "[t]he number of shares of a corporation's authorized stock that have been actually sold or otherwise distributed to investors." HOWARD BRYAN BONHAM, *THE COMPLETE INVESTMENT AND FINANCE DICTIONARY* 480 (2001).

¹⁰⁶ § 271(a).

¹⁰⁷ See Clagg, *supra* note 2, at 1306 ("At its core, section 271 is a measure enacted to protect the interests of shareholders."); see also *Gimbel v. Signal Cos.*, 316 A.2d 599, 606 (Del. Ch. 1974) ("The purpose of the consent statutes is . . . to protect the shareholder from the destruction of the means to accomplish the purposes or objects for which the corporation was incorporated and actually performs." (quoting 6A WILLIAM MEADE FLETCHER ET AL., *FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* § 2949.20 (perm. ed., rev. vol. 1968))), *aff'd*, 316 A.2d 619 (Del. 1974). Even though it provides shareholders with important protection, Section 271 was not originally enacted to protect shareholders, but instead was created to clarify and amend a common law rule governing shareholder approval for asset sales. See *Hollinger Inc. v. Hollinger Int'l, Inc.*, 858 A.2d 342, 376 (Del. Ch. 2004).

¹⁰⁸ See, e.g., § 251 (requiring shareholder approval under certain merger scenarios); *id.* § 253 (requiring parent corporation shareholder approval before parent-subsidiary merger where parent corporation does not survive); *id.* § 275 (requiring shareholder approval for dissolution of corporation).

¹⁰⁹ See, e.g., *Hollinger*, 858 A.2d at 376–78; *Gimbel*, 316 A.2d at 606.

¹¹⁰ See H.R. 150, 143rd Gen. Assemb., Reg. Sess., at Synopsis § 28 (Del. 2005).

shareholder approval requirement in a sale of all or substantially all corporate assets. This loophole demands legislative attention.

A. *The Evolution of Section 271*

When Delaware legislators feared that the state's then-antiquated corporate code was stunting its ability to attract corporate charters among competition from other states, they realized the code needed to be modernized.¹¹¹ One of the Delaware Corporation Law Revision Committee's main objectives in revising the DGCL was "to simplify the mechanics for corporate action and adjust them to the realities of modern corporate life."¹¹² As a result, Section 271 of the updated, 1967 version of the DGCL was a straightforward, two-paragraph grant for corporate boards to "sell, lease, or exchange all or substantially all" of the corporation's assets for any reason the board "deem[ed] expedient and for the best interests of the corporation."¹¹³ The only limitation was that a shareholder majority must approve the sale.¹¹⁴ Corporate boards thus had relatively broad authority, constrained only by the shareholder approval requirement, to sell corporate assets.

Section 271 quickly became a source of considerable debate, specifically with respect to the meaning of the phrase "all or substantially all," which the Delaware legislature declined to define.¹¹⁵ The Court of Chancery in *Gimbel v. Signal Cos.* attempted to clarify Section 271's definitional ambiguity in a typical display of the judiciary's "first responder" approach to addressing controversies arising under the

¹¹¹ See Andrew G. T. Moore II, *A Brief History of the General Corporation Law of the State of Delaware and the Amendatory Process*, in 1 BALOTTI AND FINKELSTEIN'S DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS, *supra* note 12. Judge Moore notes that this concern among Delaware legislators was pronounced as early as 1963, when the preamble to a statute calling for revision to the DGCL contained language lamenting Delaware's inability to remain competitive with other states and declaring "it to be the public policy of the State to maintain a favorable business climate and to encourage corporations to make Delaware their domicile." *Id.* (quoting Act of Dec. 31, 1963, ch. 218, 54 Del. Laws 724).

¹¹² S. Samuel Arsht & Walter K. Stapleton, *Delaware's New General Corporation Law: Substantive Changes*, 23 BUS. LAW. 75, 75 (1967). The other two primary objectives in the revision process were (1) "to update and clarify the language of the existing corporation law" and (2) "to make changes in the substantive provisions of the statute where experience had indicated that improvements could be made." *Id.* While these two objectives were undeniably crucial to the development of the modern DGCL, the Revision Committee's focus on simplifying the mechanics of corporate action was likely more important in Section 271's particular evolution as a means for corporations to efficiently undergo fundamental corporate change.

¹¹³ Act of July 3, 1967, ch. 50, § 271, 56 Del. Laws 151, 222–23.

¹¹⁴ *Id.* The shareholder approval was made slightly more onerous by the requirement that the shareholders had to be notified at least twenty days prior to the proposed asset sale. *See id.*

¹¹⁵ The question of what constitutes "all or substantially all" of a corporation's assets is generally considered the "question most frequently encountered under Section 271." Bussard, *supra* note 12.

DGCL.¹¹⁶ The case arose from Signal Co. shareholders' claim that majority shareholder approval was necessary to consummate the sale of all the outstanding capital stock of one of Signal Co.'s wholly owned subsidiaries.¹¹⁷ Despite noting that the purpose of requiring shareholder approval in Section 271 was not simply to protect against the sale of an important corporate asset,¹¹⁸ the Court of Chancery did observe that the fundamental thrust of shareholder consent statutes was "to protect the shareholders from fundamental change, or . . . from the destruction of the means to accomplish the purpose or objects for which the corporation was incorporated and actually performs."¹¹⁹ With these principles as a backdrop, the court shaped a common law rule that remains the standard by which courts evaluate sales of "all or substantially all" assets under Section 271: "If the sale is of assets quantitatively vital to the operation of the corporation and is out of the ordinary and substantially affects the existence and purpose of the corporation, then it is beyond the power of the Board of Directors."¹²⁰

The Delaware legislature did not amend—nor has it ever amended—Section 271 in response to the relative uncertainty within the business community as to the definition of "all or substantially all." Rather, the legislature has since permitted the *Gimbel* test to govern the fact-based determination of corporate asset sales under Section 271,¹²¹ and a degree of predictability for corporate boards thus derives from the understanding that the *Gimbel* test will always be applied to a major asset sale, not from the understanding that "all or substantially all" represents a definite quantity.

¹¹⁶ 316 A.2d 599 (Del. Ch. 1974), *aff'd*, 316 A.2d 619 (Del. 1974); *see* Hamermesh, *supra* note 11, at 1781–82; *see also* discussion *supra* Part I.C (exploring how Delaware courts first respond to statutory ambiguity, but leave remediation to the Delaware General Assembly).

¹¹⁷ *Gimbel*, 316 A.2d at 601, 605.

¹¹⁸ *Id.* at 605.

¹¹⁹ *Id.* at 606 (quoting 6A WILLIAM MEADE FLETCHER ET AL., *supra* note 107, § 2949.20).

¹²⁰ *Id.* The *Gimbel* test's significant and lasting legal force is evident in its application in other highly influential Delaware cases. *See, e.g.*, *Thorpe v. CERBCO, Inc.*, 676 A.2d 436, 444 (Del. 1996) (relying upon the *Gimbel* standard to determine that an asset sale would "constitute a radical transformation of CERBCO"); *Hollinger Inc. v. Hollinger Int'l, Inc.*, 858 A.2d 342, 377 (Del. Ch. 2004) (applying the *Gimbel* standard because "[Delaware] jurisprudence eschewed a definitional approach to § 271" (citing *Gimbel*, 316 A.2d at 606)); *Winston v. Mandor*, 710 A.2d 835, 843 (Del. Ch. 1997) ("The Supreme Court has long held that determination of whether there is a sale of substantially all assets so as to trigger section 271 depends upon the particular qualitative and quantitative characteristics of the transaction at issue." (citing *CERBCO*, 676 A.2d at 444)).

¹²¹ Compare Act of July 3, 1967, ch. 50, § 271, 56 Del. Laws 151, 222–23 (failing to clarify "all or substantially all"), with Act of May 17, 2005, ch. 30, sec. 28, § 271, 75 Del. Laws 21, 24 (failing, as well, to define "all or substantially all"). The Delaware legislature's refusal to amend Section 271 to clarify the definition of "all or substantially all" is a prime example of the symbiotic relationship between the Delaware judiciary and legislature: where courts are better equipped to create predictable, fact-based tests under the DGCL, the legislature will refrain from interfering. *See* discussion *supra* Part I.C.

In the six times that it has amended Section 271 since 1967,¹²² the Delaware legislature has never defined “all or substantially all” in response to the *Gimbel* decision.¹²³ The legislative revisions have added clarity and predictability by detailing specific requirements for corporate asset sales. For example, the 1969 revision entirely struck Section 271(a) and inserted more detail about which shareholders were entitled to vote on the asset sale,¹²⁴ and the 1985 revision added more language with respect to shareholders.¹²⁵ The most important revision to Section 271 came in 2005 as a result of the Court of Chancery’s decision in *Hollinger Inc. v. Hollinger International, Inc.*¹²⁶

In *Hollinger*, Vice Chancellor Strine considered whether a parent corporation’s¹²⁷ shareholders were required under Section 271 to approve the sale of one of the corporation’s subsidiaries.¹²⁸ *Hollinger Inc.*, a holding company and the controlling shareholder of *Hollinger International, Inc.*, argued that *Hollinger International* could not sell one of its wholly owned subsidiaries, which *Hollinger Inc.* claimed constituted substantially all of *Hollinger International, Inc.*’s assets, to a competitor.¹²⁹ The issue was one of first impression for the court because the pre-2005 language of Section 271 entirely failed to address issues surrounding wholly owned subsidiary asset sales;¹³⁰ the Delaware legislature had been silent about scenarios in which a parent corporation attempted to sell all of its subsidiary’s assets and all of the consolidated enterprise’s assets through its subsidiary.¹³¹

¹²² See Act of May 3, 2010, ch. 253, sec. 58, § 271, 77 Del. Laws 39, 47; Act of May 17, 2005, ch. 30, sec. 28, § 271, 75 Del. Laws 21, 24; Act of July 1, 1985, ch. 127, sec. 9, § 271, 65 Del. Laws 224, 225; Act of July 1, 1983, ch. 112, sec. 55, § 271, 64 Del. Laws 285, 292–93; Act of June 23, 1969, ch. 148, sec. 30, § 271, 57 Del. Laws 433, 450; Act of July 3, 1967, ch. 50, § 271, 56 Del. Laws 151, 222–23.

¹²³ For an in-depth discussion of the common law reinforcement of the *Gimbel* test, see Bussard, *supra* note 12, which tracks the Delaware judiciary’s reliance upon the *Gimbel* standard in numerous high-profile and complicated corporate disputes.

¹²⁴ Act of June 23, 1969, ch. 148, sec. 30, § 271, 57 Del. Laws 433, 450.

¹²⁵ Act of July 1, 1985, ch. 127, sec. 9, § 271, 65 Del. Laws 224, 225.

¹²⁶ 858 A.2d 342 (Del. Ch. 2004); see Clagg, *supra* note 2.

¹²⁷ A parent corporation is defined as “[a] corporation that owns the controlling interest in one or more subsidiaries. It may be an operating company or strictly a holding company.” BONHAM, *supra* note 105, at 485. A subsidiary is defined as “[a] company owned and managed completely or partially by another company, through control or ownership of a majority of all of its outstanding voting stock.” *Id.* at 633.

¹²⁸ *Hollinger*, 858 A.2d at 346.

¹²⁹ *Id.*

¹³⁰ See *id.* at 348, 373–74.

¹³¹ See DEL. CODE ANN. tit. 8, § 271 (2001); see also Clagg, *supra* note 2, at 1311 (“[T]he pre-2005 version [of Section 271] did not address how the law would treat a sale, lease, or exchange of substantially all of a wholly owned and controlled subsidiary corporation’s assets when the subsidiary’s assets represented substantially all of the consolidated enterprise’s assets.”).

Despite compelling arguments for and against a parent-company-level shareholder approval requirement in Section 271, Vice Chancellor Strine declined to provide much definitive guidance.¹³² The Vice Chancellor instead chose to resolve the dispute on economic grounds because the subsidiary in question did not constitute substantially all of the parent's assets.¹³³

Nevertheless, Vice Chancellor Strine offered instructive insights that would ultimately guide future legislative action. Specifically, Vice Chancellor Strine noted the inherent tension between a literal reading of Section 271 and the legislative intent for the DGCL to provide some inviolable protection to shareholders.

Vice Chancellor Strine observed that Hollinger International's use of Section 271's plain language—a reading that gave directors more power—limited litigation, provided clear guidance and consistency to transaction planners, and generated shareholder wealth.¹³⁴ But he also commented that a strict adherence to Section 271's plain meaning would render the provision “largely hortatory” and “easily side-stepped,” thereby leaving shareholders nakedly exposed to needless risk.¹³⁵ Vice Chancellor Strine ultimately concluded that a parent-level shareholder vote on a subsidiary asset sale “would not . . . be an irrational implementation of the legislative intent expressed in that section of our corporation code.”¹³⁶

The Delaware legislature responded to the *Hollinger* decision.¹³⁷ Less than a year later, the General Assembly added subsection (c) to Section 271, which specifically addressed subsidiary asset sales:

(c) For purposes of this section only, the property and assets of the corporation include the property and assets of any subsidiary of the corporation. As used in this subsection, “subsidiary” means any entity wholly-owned and controlled, directly or indirectly, by the corporation and includes, without limitation, corporations, partnerships, limited partnerships, limited liability partnerships, limited liability companies, and/or statutory trusts.

¹³² *Hollinger*, 858 A.2d at 348 (“Because this motion [seeking a preliminary injunction preventing the sale of Telegraph Group, Ltd.] can be resolved on substantive economic grounds and because the policy implications of ruling on [the subsidiary's] technical defense are important, prudence counsels in favor of deferring a necessarily hasty decision on the interesting question [of whether Section 271 can be interpreted to allow parent-level boards sell subsidiary assets without parent-level shareholder approval].”).

¹³³ *Id.* at 348–49.

¹³⁴ *Id.* at 374.

¹³⁵ *Id.*

¹³⁶ *Id.* at 375.

¹³⁷ The *Hollinger* decision caused notable unrest among practitioners who had previously relied upon Delaware decisions that upheld the idea that parent-level shareholder approval for subsidiary asset sales was not required. For an in-depth discussion of the concerns raised by the *Hollinger* decision prior to Section 271's 2005 amendment, see Yaman Shukairy, Note, *Megasubsidiaries and Asset Sales Under Section 271: Which Shareholders Must Approve Subsidiary Asset Sales*, 104 MICH. L. REV. 1809 (2005).

Notwithstanding subsection (a) of this section, except to the extent the certificate of incorporation otherwise provides, no resolution by stockholders or members shall be required for a sale, lease or exchange of property and assets of the corporation to a subsidiary.¹³⁸

The amendment both ostensibly resolved the uncertainty noted in *Hollinger* and provided needed predictability.¹³⁹ In effect, Section 271(c) foreclosed the ability of a parent corporation to engage in another *Hollinger*-type transaction because parent-level shareholders now had to be included in a decision to sell all or substantially all of the entire corporate enterprise's assets.¹⁴⁰ The revision was—and remains¹⁴¹—the most significant addition to Section 271 in its history.

Still, the Delaware legislature should reexamine Section 271 once again because of the loophole it contains: the sale of assets through a partially owned subsidiary without shareholder approval. The General Assembly specifically provided in its 2005 Bill Synopsis that “[t]he amendment [to Section 271] is not intended to address the application of subsection (a) to a sale, lease or exchange of assets by, or to or with, a subsidiary that is not wholly-owned and controlled, directly or indirectly, by the ultimate parent.”¹⁴² An opportunity for shareholder disenfranchisement therefore still exists, contrary to the stated purpose of Section 271.

B. Hypothetical Asset Sale Using Section 271's Loophole

Little scholarship has been devoted to exploring hypothetical asset sales under Section 271, and perhaps for good reason. Before the *Hollinger* decision and the 2005 amendment to Section 271, most practitioners understood the Delaware judiciary to be unified on the topic of parent-level shareholder approval under Section 271.¹⁴³ As such, there was little reason to question the scenarios in which a corporate asset sale might trigger shareholder voting rights. The relative uncertainty created by *Hollinger* fostered some speculation about the decision's ramifications for corporate

¹³⁸ Act of May 17, 2005, ch. 30, sec. 28, § 271, 75 Del. Laws 21, 24.

¹³⁹ See H.R. 150, 143rd Gen. Assemb., Reg. Sess., at Synopsis § 28 (Del. 2005) (“Section 271 has been amended to add new subsection (c). The purpose of subsection (c) is to provide that . . . (ii) the assets of such a subsidiary are to be treated as assets of its ultimate parent for purposes of applying, at the parent level, the requirements set forth in subsection (a).”).

¹⁴⁰ See Clagg, *supra* note 2, at 1313–14.

¹⁴¹ The legislature amended Section 271 once more in 2010, but the revision merely clarified which members of a nonstock corporation are entitled to vote on the corporation's asset sale. See Act of May 3, 2010, ch. 253, sec. 58, § 271, 77 Del. Laws 39, 47.

¹⁴² H.R. 150, 143rd Gen. Assemb., Reg. Sess., at Synopsis § 28 (Del. 2005) (emphasis added).

¹⁴³ See Shukairy, *supra* note 137, at 1811 (noting that until the *Hollinger* decision, “the Delaware courts had summarily concluded that the only vote required was the vote of ‘the record holder of all of the shares,’ obviating the need to attain shareholder approval from shareholders of a parent corporation”).

asset sales,¹⁴⁴ including a scholarly note essentially arguing that the *Hollinger* decision was flawed.¹⁴⁵ After the 2005 amendment to Section 271, a degree of predictability was restored to the corporate and judicial arenas, but commenters still found opportunities to question the amendment's effects.¹⁴⁶

There are few examples of hypotheticals considering Section 271's real-life effects: one scholarly note explored Section 271's possible effects on a hypothetical "Cash-Out Merger,"¹⁴⁷ and two Delaware practitioners considered questions and issues raised by Section 271 with respect to a hypothetical parent corporation and its subsidiary.¹⁴⁸ Yet there has been virtually no consideration¹⁴⁹ of how a corporation might take advantage of the loophole in Section 271 with respect to shareholder approval (or the lack thereof) for a partially owned subsidiary's asset sale, nor has there yet been a documented exploitation of the loophole by a corporation.¹⁵⁰ To illustrate Section 271's loophole as it would be applied practically, this Part

¹⁴⁴ See Morton & Reilly, *supra* note 15, at 3 ("The Court's apparent willingness to collapse the corporate existence of the parent and subsidiary corporations in *Hollinger* for purposes of Section 271 prompted many to consider what effect the decision would have on the reasoned analysis many had offered before when addressing dispositions of assets in the parent/subsidiary context."); see also Paschetto, *supra* note 15, at 6 ("Before the 2005 amendment to Section 271, arguments were made for both sides of the question involving the sale of a subsidiary's assets.")

¹⁴⁵ Shukairy, *supra* note 137, at 1813. Although Shukairy did not delve into analysis of specific hypothetical transactions, the implications of his arguments are clear for corporate transactions because he argues for the pre-*Hollinger* standard for parent-level shareholder approval, which was well-known at the time. *Id.* at 1824–33 (arguing that Delaware's emphasis on separate corporate existence, form-over-substance transactions, and fiduciary duties supports an interpretation of Section 271 that would not require parent-level shareholder approval for a subsidiary asset sale).

¹⁴⁶ See, e.g., Morton & Reilly, *supra* note 15, at 7–12 (raising practical questions about the effects of the amended Section 271); Clagg, *supra* note 2, at 1314–24 (noting concerns that amending Section 271 without similarly amending Section 251 potentially incentivizes boards to avoid Section 271—and the attendant shareholder vote—by relying on Section 251 "Cash-Out Mergers").

¹⁴⁷ Clagg, *supra* note 2, at 1309, 1320–24 (arguing that the strictures of the amended Section 271 would drive corporate boards to rely instead on "cash-out mergers" under Section 251 to reach the identical substantive effect of a full subsidiary asset sale, which would avoid a shareholder vote).

¹⁴⁸ Morton & Reilly, *supra* note 15, at 7–12 (raising practical questions and providing educated forecasting for clients and other practitioners in the wake of the 2005 amendment to Section 271).

¹⁴⁹ Morton and Reilly, in their article in *Deal Points: The Newsletter of the Committee on Negotiated Acquisitions*, briefly mention the probable inapplicability of Section 271's shareholder approval requirement to asset sales by partially owned subsidiaries. See *id.* However, they failed to show how a corporation would actually structure the transaction, so the topic deserves more analysis.

¹⁵⁰ An examination of Delaware's judicial record shows no adjudication of Section 271's loophole. The loophole may not be the subject of litigation for several reasons, including corporations' disinterest in exploiting the loophole (for fear of inciting litigation), lack of awareness about the loophole, or tacit approval by shareholders of such corporate action. After all, as shown in the hypothetical transaction, a corporation exploiting Section 271's loophole can significantly improve its liquidity, which likely would translate into a dividend distribution for shareholders or the corporation's entry into a new, potentially more lucrative market or business opportunity.

explores a hypothetical asset sale involving a parent corporation, Pater Corp., and its subsidiary, Filius Corp.¹⁵¹

1. *Pater Corp. and Filius Corp.'s Incorporation and Asset Transfer.*—Pater Corp. incorporated in Delaware to produce farming equipment and acquired a significant amount of manufacturing assets necessary for its business. Pater Corp.'s board of directors then incorporated a subsidiary, Filius Corp., into which Pater Corp. placed all of its manufacturing assets in exchange for all 10,000 shares of Filius Corp.'s stock.¹⁵² As its sole shareholder, Pater Corp. wholly owned Filius Corp.; in turn, Filius Corp. held all or substantially all of the consolidated corporate enterprise's assets.¹⁵³ As part of a corporate strategy to improve liquidity, Pater Corp. issued its shares to the public. Pater Corp. became a publicly held corporation. Filius Corp., however, was still wholly owned and controlled only by Pater Corp.'s board.¹⁵⁴

2. *Pater Corp. Intends to Sell Filius Corp.'s Assets.*—As Filius Corp.'s manufacturing business grew more successful, Pater Corp. was approached by strategic buyers wanting to acquire all of Filius Corp.'s assets. Pater Corp., eager to pursue a new corporate direction because of a projected manufacturing downturn, was receptive to the cash influx an asset sale would generate. After considering numerous competing bids,¹⁵⁵ Farming Corp. stood out as the highest and most attractive bidder. Early one month, Farming Corp. approached Pater Corp.'s board of directors with an appealing offer. The next week, Pater Corp.'s board met and

¹⁵¹ The following hypothetical transaction is necessarily oversimplified: it does not consider some of the practical implications of a major asset sale, such as the time it might take attorneys to negotiate the deal's final terms or to conduct thorough due diligence. The following hypothetical instead serves only to highlight the relative speed with which a transaction utilizing Section 271's ostensible loophole could be brought to fruition compared to a transaction necessitating a parent-level shareholder vote.

¹⁵² This asset exchange from parent to subsidiary does not require shareholder approval under Section 271(c).

¹⁵³ See DEL. CODE ANN. tit. 8, § 271(c) (2011).

¹⁵⁴ "Closely-held" or "close" corporations are those that "have relatively few shareholders . . . and [for which] there is no public market for buying or selling interests in them." DAVID G. EPSTEIN ET AL., BUSINESS STRUCTURES 109 (3d ed. 2010). Publicly held or "public" corporations are those that "have many shareholders and [for which] the interests in them are publicly traded (for instance, on stock exchanges)." *Id.* The major difference between the two exists in the amount of control shareholders can expect to exercise over corporate governance. See Douglas K. Moll, *Shareholder Oppression & Dividend Policy in the Close Corporation*, 60 WASH. & LEE L. REV. 841, 846-47 (2003) ("In the traditional public corporation, the shareholder is normally a detached investor who neither contributes labor to the corporation nor takes part in management responsibilities. In contrast, within a close corporation, 'a more intimate and intense relationship exists between capital and labor.'").

¹⁵⁵ The Pater Corp. board would need to ensure that it received the highest bid possible in order to comply with the *Unocal* and *Revlon* standards, which obligate a board to determine whether a takeover offer is in the best interest of the corporation, see *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985), and to procure the highest bid when the board's role becomes that of an auctioneer, see *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 184 (Del. 1986).

decided to sell all of Filius Corp.'s—and thus all of Pater Corp.'s—assets as quickly and efficiently as possible.

Prior to the *Hollinger* decision and 2005 amendment to Section 271, Pater Corp. could have sold all or substantially all of Filius Corp.'s assets through a simple approval by Pater Corp.'s board of directors; none of Pater Corp.'s public shareholders would have been required to approve the sale.¹⁵⁶ Nevertheless, the post-2005 Section 271(c) mandated parent-level shareholder approval under these circumstances, which may have taken too long for Pater Corp.'s purposes¹⁵⁷ if its shareholders were reluctant to sell all of the corporate enterprise's assets.

3. *Pater Corp. Uses Section 271's Loophole to Avoid a Shareholder Vote.*—The Pater Corp. board decided to creatively avoid a Pater Corp.-level shareholder vote: the board gave 1% of its Filius Corp. stock (100 shares) to a third party who knew all members of Pater Corp. and Filius Corp. boards. This stock transfer made Filius Corp. a partially owned subsidiary of Pater Corp., technically no longer under the purview of Section 271.¹⁵⁸

Although the Pater Corp. board could no longer ostensibly make a unilateral decision to sell all of the consolidated corporate entity's assets, its 99% control of Filius Corp.'s outstanding shares ensured it had total control over the election of Filius Corp.'s board members.¹⁵⁹ Furthermore, because the Filius Corp. board had been directly appointed by the Pater Corp. board—because Pater Corp. owned all of Filius Corp.'s stock—the Filius Corp. board was almost certain to agree with the Pater Corp. board's business judgment regarding the new corporate direction. Nevertheless, the Pater Corp. board was careful not to appear as if it was controlling the transaction¹⁶⁰ and, over the next few weeks, presented the Filius Corp. board with the benefits of the asset sale in the context of the consolidated corporate entity's future.

¹⁵⁶ See Shukairy, *supra* note 137, at 1811.

¹⁵⁷ Pater Corp. might want to sell its assets quickly to take advantage of a new market opportunity or because it forecasts a deterioration in its current market position and wants to extricate itself with a significant cash influx before its financial situation sours.

¹⁵⁸ See DEL. CODE ANN. tit. 8, § 271(c) (2011).

¹⁵⁹ See *id.* §§ 141(k), 212. Pater Corp.'s control over Filius Corp.'s board member elections would be complete both in straight and cumulative voting scenarios. In any event, Pater Corp.'s voting majority would not matter—even if Pater Corp. had given the well acquainted third party 49% of Filius's stock—because Filius Corp.'s third-party minority shareholder would very likely have voted with Filius Corp. board members amenable to Pater Corp.'s goals.

¹⁶⁰ Morton and Reilly suggest that a parent corporation could effect an asset sale through a partially owned subsidiary without needing shareholder approval, provided the parent corporation “does not direct or control the sales process for its subsidiary.” See Morton & Reilly, *supra* note 15, at 11.

Early the next month,¹⁶¹ Farming Corp. approached Filius Corp. directly with its offer to purchase all of its assets. The Filius Corp. board approved the sale two weeks later and, pursuant to Section 271(a), Pater Corp.'s board approved the asset sale by voting its majority shares the same afternoon. Farming Corp. then paid cash for all of Filius Corp.'s assets.¹⁶² Filius Corp. then effectively became a shell corporation with cash as its only asset.¹⁶³ Pater Corp.'s public shareholders were not required to approve the asset sale because of Section 271's plain language, which only applies to "wholly-owned and controlled" subsidiaries.¹⁶⁴

4. *The Aftermath of the Transaction.*—Filius Corp. dissolved, distributed the sale proceeds to its shareholders (Pater Corp. and the 1% third-party owner), and wound up its operations.¹⁶⁵ Pater Corp. used the asset sale proceeds to pursue a new corporate direction. Pater Corp.

¹⁶¹ Although exploiting Section 271's loophole is faster than procuring shareholder approval to sell all or substantially all of a corporation's assets, the approval process undertaken by the respective boards of directors would still take several weeks. The reason is that both Pater Corp. and Filius Corp.'s boards have fiduciary responsibilities to exercise independent judgment about the deal's merits in compliance with the "entire fairness test," which requires *both* a fair price and fair dealing. *See, e.g., In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 52 (Del. 2006) (noting that corporate directors can overcome an assertion of acting in bad faith by "demonstrat[ing] that the challenged act or transaction was entirely fair to the corporation and its shareholders"); *Reis v. Hazelett Strip-Casting Corp.*, 28 A.3d 442, 459 (Del. Ch. 2011) ("Once entire fairness applies, the [directors] must establish 'to the court's satisfaction that the transaction was the product of both fair dealing *and* fair price.'" (quoting *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1156, 1163 (Del. 1995))). As a result, corporate boards must consider "all material information reasonably available to them" prior to making a fundamental corporate change, which requires more than a few days' consideration. *See Smith v. Van Gorkom*, 488 A.2d 858, 872, 874 (Del. 1985) (holding that the board of directors was grossly negligent in approving the sale of its company "upon two hours' consideration, without prior notice, and without the exigency of a crisis or emergency"), *overruled on other grounds by Gantler v. Stephens*, 965 A.2d 695 (Del. 2009).

¹⁶² Farming Corp.'s authority to acquire Filius Corp.'s assets from Pater Corp. arises in DGCL Section 122(4), which permits corporations to buy, sell, and exchange assets, including cash and stock. *See* § 122(4).

¹⁶³ For a diagrammatical depiction of a substantially similar transaction, see DALE A. OESTERLE, *THE LAW OF MERGERS AND ACQUISITIONS* 41 (4th ed. 2012).

¹⁶⁴ § 271(c). Alternatively, Pater Corp. possibly could have structured the transaction to avoid a parent-level shareholder vote by having Farming Corp. buy all of Filius Corp.'s stock, which would have the same economic result as this hypothetical. However, the deal structure would have implicated Section 251, not Section 271. *See id.* § 251. Robert J. Clagg Jr. explored this cash-for-stock workaround to Section 271 in his Note, *An "Easily Side-Stepped" and "Largely Hortatory" Gesture?: Examining the 2005 Amendment to Section 271 of the DGCL*. *See* Clagg, *supra* note 2, at 1320–24. Because this Comment's focus is exclusively Section 271, I will only note that, under the alternate cash-for-stock transaction, the Pater Corp. shareholders might have a strong argument that Pater Corp.'s only true asset was its Filius Corp. stock, and therefore Pater Corp. violated Section 271 by selling all of its assets without shareholder approval.

¹⁶⁵ This process would involve paying Filius Corp.'s creditors and other outstanding liabilities because asset sales almost never involve the buyer assuming any of the seller's liabilities, which is a prime reason why asset sales are very popular corporate transactions. *See* OESTERLE, *supra* note 163, at 39.

shareholders filed direct and derivative suits, claiming Pater Corp.'s board breached its fiduciary duties by circumventing Section 271(a)'s shareholder approval requirement. Pater Corp. relied on the "compelling justification" and "entire fairness" standards¹⁶⁶ as a defense based on the board's desire to explore new profitmaking opportunities as quickly as possible, which added significant value for the Pater Corp. shareholders.

It is difficult to predict with certainty how the Delaware Court of Chancery would rule on Pater Corp.'s shareholders' claims in this transaction. But it is easy to see the speed and efficiency with which Pater Corp. could effect this type of asset sale by using Section 271's loophole and the rational defense it could present to justify its actions. Pater Corp. would have a strong defense that it relied upon the black letter of the DGCL, which would seriously undermine a shareholder suit. More importantly, this hypothetical transaction presents numerous issues that implicate corporations, shareholders, and the status of the DGCL.

III. SHOULD SECTION 271 BE AMENDED? RAMIFICATIONS FOR CORPORATIONS, SHAREHOLDERS, AND THE FUTURE OF THE DGCL

As explored in Part II.B, the relative ease with which a corporation could take advantage of Section 271's loophole structure raises many concerns for corporations, shareholders, and the future of the DGCL. Vice Chancellor Strine's commentary in *Hollinger* remains pertinent: There is a manifest tension between a consistent, predictable interpretation of the DGCL and the preservation of shareholder rights.¹⁶⁷ Reading Section 271 literally (i.e., with the identified loophole) reinforces Delaware's support for corporate efficiency and autonomy, but it also undermines Delaware's commitment to shareholder rights. Furthermore, Section 271, as it currently reads, presents an opportunity for the legislature to reexamine the balance between the section's freedom of contract premise and its inherent risk of corporate opportunism. Ultimately, Section 271 should be amended to extend to asset sales through partially owned subsidiaries.

A. *Section 271 Reinforces Corporate Efficiency and Private Ordering*

The DGCL fundamentally rests upon the principle of private ordering between corporations and their shareholders, which necessarily fosters

¹⁶⁶ Typically, the business judgment presumption is the standard under which board actions are assessed. See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985). However, in *Blasius Industries, Inc. v. Atlas Corp.*, the Court of Chancery established the rule that a board's acts "done for the primary purpose of impeding the exercise of stockholder voting power" require a "compelling justification." 564 A.2d 651, 661 (Del. Ch. 1988). However, given Section 271's plain language, there might be a convincing argument for using the business judgment presumption in a Section 271 partial subsidiary asset sale. See *supra* notes 93–95 and accompanying text.

¹⁶⁷ See *Hollinger Inc. v. Hollinger Int'l, Inc.*, 858 A.2d 342, 374 (Del. Ch. 2004).

efficiency and autonomy in corporate governance and transactions.¹⁶⁸ Delaware's emphasis on corporate autonomy stems in part from a desire to remain the premier state of incorporation.¹⁶⁹ The asset sale described in Part II.B demonstrates that Section 271's loophole allows corporate boards to quickly and easily sell all or substantially all of the corporation's assets without parent-level shareholder approval. As such, the loophole is favorable to corporate boards even though it raises concerns for shareholders.¹⁷⁰ Assuming corporate boards adhere to their fiduciary duties and do not use Section 271 to diminish shareholder value,¹⁷¹ corporations could sell an asset through a partially owned subsidiary to take advantage of a temporarily favorable market or other time-sensitive deal conditions without having to fear losing a corporate opportunity because of the onerous shareholder approval process.¹⁷²

Moreover, shareholder value could be greatly enhanced by using Section 271's loophole. For example, after selling all or substantially all of its assets in a very short time, a parent corporation could take the sale proceeds and immediately use them for a major acquisition or to pay a large dividend to its shareholders. Provided that time is of the essence in a particular wealth-maximizing deal, it seems unlikely that shareholders would retrospectively object to using Section 271's loophole to avoid a shareholder vote. Indeed, even if shareholders did object to a corporation's asset sale, a Delaware court may be more inclined to accept the board's actions to enhance shareholder wealth as a "compelling justification."¹⁷³

Furthermore, as discussed in Part II.A, the Delaware legislature appears to implicitly endorse such a transaction in its Bill Synopsis of the

¹⁶⁸ See, e.g., Smith et al., *supra* note 64, at 128 (arguing that transaction cost economics support private ordering); Leo E. Strine Jr., *Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1257, 1263 (2001) (positing that large corporations choose Delaware for incorporation because the DGCL's "preference for flexibility rather than rigidity allows corporate boards to structure corporate transactions in a manner best tailored to the particular circumstances their corporations face"); Welch & Saunders, *supra* note 43, at 848 ("The DGCL gives stockholders broad discretion to establish at the outset whatever terms for the organization, management, and finance of the corporation they believe will best serve the needs of the particular enterprise.").

¹⁶⁹ See Hamermesh, *supra* note 11, at 1786; Ward & Kelly, *supra* note 88.

¹⁷⁰ See *infra* Part III.B.

¹⁷¹ See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985).

¹⁷² See OESTERLE, *supra* note 163, at 37 ("Since the turnout at shareholder meetings is often less than 75 percent of the outstanding voting shares, a successful vote on a merger can require an affirmative vote of well over a majority of those represented at or attending the shareholders' meeting (67 percent of the shares present if only 75 percent of the outstanding shares are represented, for example)."); *Private vs. Public Deals*, *supra* note 13 (stating that shareholder approval procedures for straightforward corporate transactions typically last eight to ten weeks).

¹⁷³ See *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 661 (Del. Ch. 1988); see also *City of Westland Police & Fire Ret. Sys. v. Axcelis Techs., Inc.*, 1 A.3d 281, 288 (Del. 2010) (citing *Blasius*, 564 A.2d at 661) (reaffirming the *Blasius* "compelling justification" standard).

2005 amendment to Section 271. The General Assembly expressly provided that 271(c) did not apply to partially owned or controlled subsidiaries.¹⁷⁴ This might indicate that the General Assembly implicitly approved using a partially owned subsidiary to sell all or substantially all of a corporate enterprise's assets. Given the Delaware judiciary's adherence to the plain meaning rule,¹⁷⁵ desire to preserve legal predictability,¹⁷⁶ and respect for the director-centered nature of the DGCL,¹⁷⁷ it is not unreasonable to think that the courts will construe Section 271's loophole in favor of corporations.

Nevertheless, even though Section 271(c) supports corporate efficiency, and legislative intent and Delaware's jurisprudence support a strict interpretation of the DGCL's plain language, there is still cause for concern among corporate boards pondering asset sales through a partially owned subsidiary. Mark Morton and Michael Reilly, two Delaware practitioners, suggest that the level of control a parent corporation's board wields over its subsidiary may be a central issue in a court's assessment of whether a board acted appropriately by selling assets through a partially owned subsidiary.¹⁷⁸ Morton and Reilly suggest that Delaware courts might construe "control" in Section 271(c) as "requiring a showing of the actual exercise of control over the subsidiary."¹⁷⁹ However, as the authors also point out, the courts have yet to consider this question.¹⁸⁰

Corporations, therefore, are faced with a degree of unpredictability that may dissuade many from engaging in a partially owned subsidiary asset sale due to the likelihood of litigation and the potential for an adverse

¹⁷⁴ See H.R. 150, 143rd Gen. Assemb., Reg. Sess., at Synopsis § 28 (Del. 2005).

¹⁷⁵ See *supra* Part I.A; see also, e.g., *Crown EMAK Partners, LLC v. Kurz*, 992 A.2d 377, 398 (Del. 2010) (holding that the Court of Chancery's interpretation of DGCL Section 219 was incorrect and that any ambiguity in the section should be cured by the legislature because "[t]he DGCL is a comprehensive and carefully crafted statutory scheme that is periodically reviewed by the General Assembly"); *Scattered Corp. v. Chi. Stock Exch., Inc.*, 671 A.2d 874, 877–78 (Del. Ch. 1994) (holding that the absence of plain language in DGCL Section 220 pertaining to inspection rights of members of nonstock corporations, when read in harmony with related DGCL provisions, gave no general inspection rights).

¹⁷⁶ See Micheletti & Clark, *supra* note 40, at 17–19 (arguing that the Court of Chancery's decisions demonstrate its commitment to providing guidelines to help the corporate bar "chart a course . . . toward the best corporate practices").

¹⁷⁷ DEL. CODE ANN. tit. 8, § 141(a) (2011) ("The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors . . ."); see also Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791, 801 (2002) ("The vast majority of corporate decisions accordingly are made by the board of directors alone (or by managers acting under delegated authority). The statutory decisionmaking model thus is one in which the board acts and shareholders, at most, react.").

¹⁷⁸ See Morton & Reilly, *supra* note 15, at 7–9.

¹⁷⁹ *Id.* at 9.

¹⁸⁰ *Id.*; see also Hamermesh, *supra* note 11 (explaining that the legislature did not attempt to define "control" or "order" in its 2005 amendment of Section 271, instead deferring to the courts "to supply interpretations of the underlying statute to the extent that it remained unclear in its application").

judgment,¹⁸¹ especially in light of the “compelling justification” standard courts would likely¹⁸²—but not necessarily¹⁸³—apply. This standard nevertheless is more exacting than the business judgment rule, which gives a corporate board a rebuttable presumption that it acted appropriately unless a shareholder can show that the board breached a fiduciary duty.¹⁸⁴ The business judgment rule, by comparison, requires a corporate board to show that its maneuvering around shareholder approval was in the shareholders’ best interests.¹⁸⁵ Moreover, the *Blasius Industries, Inc. v. Atlas Corp.* “compelling justification” standard is only applied when a board acts to thwart a shareholder vote.¹⁸⁶ So, a corporation utilizing Section 271’s loophole may have a viable argument that, because Section 271’s plain language does not appear to require a parent-level shareholder vote for a partially owned subsidiary asset sale, the business judgment presumption should be applied to parent-level board actions rather than the *Blasius* standard.¹⁸⁷

Nevertheless, because the stakes of potential litigation inevitably will be high and the legal presumptions against a board could be difficult to rebut,¹⁸⁸ corporations may be reluctant to test the waters in court. More

¹⁸¹ Vice Chancellor Strine suggests that large corporations willingly accept the risk of litigation in Delaware because of the judiciary’s expert ability to “produc[e] rational results” and predictably interpret the DGCL. See Strine, *supra* note 168, at 1263–64. Logically, then, the absence of predictability on certain corporate issues, through either the lack of precedent or ambiguous statutory language, provides a significant disincentive for corporations to engage in certain corporate behaviors or transactions.

¹⁸² See *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 661 (Del. Ch. 1988).

¹⁸³ See *City of Westland Police & Fire Ret. Sys. v. Axcelis Techs., Inc.*, 1 A.3d 281, 288–89 (Del. 2010); *Blasius*, 564 A.2d at 661–62.

¹⁸⁴ *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 360 (Del. 1993) (internal quotation marks omitted) (“As a rule of evidence, [the business judgment rule] creates a presumption that in making a business decision, the directors of a corporation acted on an informed basis [i.e., with due care], in good faith and in the honest belief that the action taken was in the best interest of the company.” (quoting *Citron v. Fairchild Camera & Instrument Corp.*, 569 A.2d 53, 64 (Del. 1989))).

¹⁸⁵ See *Blasius*, 564 A.2d at 661 (quoting *Aprahamian v. HBO & Co.*, 531 A.2d 1204, 1206–07 (Del. Ch. 1987)); see also *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27, 52 (Del. 2006) (stating that the business judgment rule affords directors some discretionary latitude with respect to corporate actions, but that if a fiduciary duty is shown to have been breached, then “the burden then shifts to the director defendants to demonstrate that the challenged act or transaction was entirely fair to the corporation and its shareholders” (citing *Emerald Partners v. Berlin*, 787 A.2d 85, 91 (Del. 2001))).

¹⁸⁶ See 564 A.2d at 661.

¹⁸⁷ See Jacob A. Kling, Note, *Disenfranchising Shareholders: The Future of Blasius After Mercier v. Inter-Tel*, 119 YALE L.J. 2040, 2054 (2010); see also Clagg, *supra* note 2, at 1326–27 (noting that the *Blasius* standard is sparingly applied because “business transactions typically have some professed purpose other than impeding the shareholder franchise, while decisions involving the electoral process or the appointment of directors do not”).

¹⁸⁸ The “compelling justification” standard is offered by corporate boards as a defense to an ostensible breach of fiduciary duty, particularly with respect to avoiding a shareholder vote, and it is a difficult standard to meet. See, e.g., *Blasius*, 564 A.2d at 661 (noting that the “compelling justification” standard is a “heavy burden”). But see *Mercier v. Inter-Tel (Del.)*, Inc., 929 A.2d 786, 819 (Del. Ch.

important, however, is how a court might view a parent corporation's sale of all of its assets through a partially owned subsidiary in light of the general protections and rights enjoyed by shareholders in Delaware and Delaware's commitment to avoiding shareholder disenfranchisement.

B. Section 271 Undermines Shareholder Protection

Despite Delaware's emphasis on private ordering and its assumption that bargaining between corporations and shareholders maximizes overall wealth,¹⁸⁹ the Delaware legislature and judiciary remain firmly committed to protecting shareholders from corporate boards making decisions unilaterally without shareholder input. This is evident in the numerous DGCL provisions that provide inviolable shareholder rights¹⁹⁰ and the substantial body of judicial precedent upholding the equitable principles of fiduciary duties.¹⁹¹ Corporate boards taking advantage of Section 271's loophole may use Delaware's emphasis on efficiency and private ordering to their benefit, but they simultaneously deprive shareholders of their ability to weigh in on a fundamental corporate change.¹⁹² As it stands, Section 271 undermines the shareholder protection inherent in the DGCL. It even has the potential to foster reluctance among potential investors to purchase shares of Delaware corporations they see as willing to use Section 271's loophole to disenfranchise its shareholders.

The evolution of Section 271, particularly its 2005 amendment,¹⁹³ provides the most compelling indication that the Delaware legislature recognizes the need for shareholders to have a voice in the sale of all or substantially all of a corporation's assets. Recognizing the potential for corporate board opportunism, the Delaware legislature amended Section 271 to nearly foreclose the ability of boards to unilaterally and fundamentally change the corporation without first consulting the shareholders who vested them with power in the first place.¹⁹⁴ Although the legislative record expressly mentions that the 2005 amendment did not

2007) ("When directors act for the purpose of preserving what the directors believe in good faith to be a value-maximizing offer, they act for a compelling reason in the corporate context.").

¹⁸⁹ See Welch & Saunders, *supra* note 43, at 847–48.

¹⁹⁰ See, e.g., DEL. CODE ANN. tit. 8, §§ 109, 141, 151, 211–212, 220, 251, 271 (2011).

¹⁹¹ See, e.g., *Gantler v. Stephens*, 965 A.2d 695, 708–09 (Del. 2009); *Malone v. Brincat*, 722 A.2d 5, 10 (Del. 1998); *Broz v. Cellular Info. Sys., Inc.*, 673 A.2d 148, 157 (Del. 1996); Strine, *supra* note 82 (observing that Delaware's technique of assessing whether a board breached its fiduciary duties in a corporate action operates by the maxim that "simply because [an] action is statutorily or contractually lawful, does not mean that it is equitable").

¹⁹² See Joel Edan Friedlander, *Overtune Time-Warner Three Different Ways*, 33 DEL. J. CORP. L. 631, 633–34, 640–41 (2008) (commenting that the DGCL gives shareholders an immutable right to vote on fundamental corporate changes, like sales of all or substantially all assets).

¹⁹³ See discussion *supra* Part II.A.

¹⁹⁴ See H.R. 150, 143rd Gen. Assemb., Reg. Sess. § 28 (Del. 2005); see also DEL. CODE ANN. tit. 8, § 271 (2011); *Hollinger Inc. v. Hollinger Int'l, Inc.*, 858 A.2d 342, 374 (Del. Ch. 2004).

contemplate asset sales through a partially owned subsidiary,¹⁹⁵ the thrust of the legislature's action is evident. A sale of all or substantially all of a corporation's assets that avoids a shareholder vote through the use of a partially owned subsidiary is nearly identical to the prohibited asset sale through a wholly owned subsidiary without shareholder approval. It seems extremely unlikely that the legislature would condone one while prohibiting the other, and greater clarity is needed.¹⁹⁶ Although the courts are the entities tasked with policing "overly opportunistic behavior on the part of those in control"¹⁹⁷ by applying exacting review standards to board action,¹⁹⁸ the line between corporate opportunism and a compelling justification for a fundamental corporate change is difficult to discern.¹⁹⁹ As a result, Section 271 exposes shareholders to undue risk by permitting boards to make a significant corporate change provided there is some underlying business purpose—an exceptionally easy rationale for a creative board of directors to supply.

A potential consequence of the shareholder risk exposure inherent in Section 271 is the hesitance with which prospective shareholders might choose to invest in Delaware corporations. Investors with knowledge of Section 271's loophole—and a board's ability to easily exploit it—might view large corporations with aggressive boards and histories of significant transactions as an undue risk. Shareholders already invest in Delaware corporations with the knowledge that they have virtually no control over corporate actions.²⁰⁰ Still, what little control shareholders possess is at least partially consolidated in approving significant corporate transactions.²⁰¹ Effectively removing one fundamental avenue through which shareholders can participate in corporate governance has the potential to disrupt the "stability and continuity of the existing balance of authority among managers and shareholders."²⁰²

If risk-averse shareholders lose faith in corporate boards to act in the shareholders' best interests—or simply to deal with shareholders in a straightforward and honest manner—investment could fall and corporations would feel the sting. Shareholders who feel they have no say in a fundamental corporate change—or who feel that a board utilizing this loophole equates to a threat against shareholders²⁰³—may be reluctant to

¹⁹⁵ H.R. 150, at Synopsis § 28.

¹⁹⁶ See *infra* Part III.C.

¹⁹⁷ Hamermesh, *supra* note 11, at 1784.

¹⁹⁸ See *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 661 (Del. Ch. 1988).

¹⁹⁹ See Clagg, *supra* note 2, at 1326–27 & n.174.

²⁰⁰ Bainbridge, *supra* note 177, at 800–01.

²⁰¹ See, e.g., DEL. CODE ANN. tit. 8, §§ 251–252, 271, 275 (2011).

²⁰² Hamermesh, *supra* note 79, at 414.

²⁰³ See Robert B. Thompson & D. Gordon Smith, *Toward a New Theory of the Shareholder Role: "Sacred Space" in Corporate Takeovers*, 80 TEX. L. REV. 261, 312 n.250 (2001) ("[W]e believe that shareholders should be allowed to challenge director defensive actions any time they threaten

invest. Admittedly, lost shareholder confidence would have to occur on a large scale for corporations to be seriously affected, and corporations could amend their bylaws to prevent the use of Section 271's loophole.²⁰⁴ There also is no indication that shareholders have lost confidence in corporate boards because of Section 271's loophole—despite the loophole being present since 2005—and no lawsuits have been filed in Delaware to contest the provision. Whether this is a product of a lack of shareholder knowledge or of shareholders' voluntary assumption of the risk is unclear. Nevertheless, Section 271's loophole creates noticeable risk for shareholders and, by extension, for corporations. As a result, the Delaware legislature should reevaluate and amend Section 271 to close its loophole and put investors' minds at ease.

C. *The Legislature Should Reexamine and Amend Section 271*

The Delaware legislature frequently evaluates—but only reluctantly amends—the DGCL.²⁰⁵ When it does amend the DGCL, the legislature proceeds with the goal that any revisions must derive “significant benefit . . . without any countervailing disruption.”²⁰⁶ This philosophy surely was at least part of the impetus for amending Section 271 in 2005 to provide greater shareholder protection.²⁰⁷ Still, the legislature intentionally left open the possibility that partially owned subsidiaries could be used to bypass parent-level shareholder approval in significant asset sales,²⁰⁸ thus opening the door for potential countervailing disruption if a corporate board used the loophole to unilaterally sell all of its assets.

Because the legislature expects the judiciary to first address ambiguity and potential problems in the DGCL,²⁰⁹ and because Section 271's loophole has not yet been litigated,²¹⁰ the legislature likely has seen no reason to reevaluate Section 271. Nonetheless, as this Comment demonstrates, the loophole in Section 271 warrants legislative reevaluation. Reconsidering Section 271 could be accomplished quite easily and would provide corporate boards, practitioners, and judges with the predictability that remains the hallmark of Delaware corporate law.²¹¹ Furthermore, closing

shareholder action in the limited areas assigned to shareholders. Obviously, when discussing actions by the board of directors—the group assigned to protect shareholders—potential threats assume a different form than threats from an outsider.”).

²⁰⁴ See § 109.

²⁰⁵ See Hamermesh, *supra* note 11, at 1772.

²⁰⁶ *Id.*

²⁰⁷ Section 271, by its very nature, was structured to provide shareholder protection when corporations attempted to effect a merger clothed as an asset sale. See Clagg, *supra* note 2, at 1306–07.

²⁰⁸ See H.R. 150, 143rd Gen. Assemb., Reg. Sess., at Synopsis § 28 (Del. 2005).

²⁰⁹ Hamermesh, *supra* note 11, at 1782.

²¹⁰ See Morton & Reilly, *supra* note 15, at 12.

²¹¹ See Hamermesh, *supra* note 79, at 414.

the loophole in Section 271 would achieve the greatest amount of predictability with the least effort: the legislature could make a clear pronouncement about Section 271's application to partially owned subsidiaries while saving the courts from struggling to interpret the current omission of language directed at partially owned subsidiaries.

One potential impediment to legislative amendment of Section 271 is that the provision is one of the nation's most detailed and protective of shareholders.²¹² Even California, a state typically very protective of shareholders,²¹³ entirely fails to contemplate sales of all or substantially all of a corporation's assets through a subsidiary in its corporate law.²¹⁴ The Delaware legislature may consider this difference sufficient to guarantee that shareholders will continue to view Delaware as a state in which they will be adequately protected from corporate opportunism. Furthermore, the legislature may fear that amending Section 271 to further protect shareholders will begin to discourage businesses from incorporating in Delaware. Additionally, keeping Section 271 in its current form would allow business as usual to continue in Delaware—a desirable option, to say the least.²¹⁵

Nevertheless, it behooves the Delaware legislature to weigh the pros of reexamining Section 271 with the cons of allowing the latent uncertainty surrounding Section 271's loophole to remain. The process by which the Council could consider and propose an amendment to Section 271 takes relatively little time,²¹⁶ and an amendment closing the loophole would require only a few words about Section 271's shareholder approval requirement applying to partially owned subsidiaries.²¹⁷ Although Section 271 affords corporations a potentially useful and efficient method of effecting a major corporate change for the shareholders' ostensible benefit,

²¹² See, e.g., 805 ILL. COMP. STAT. ANN. 5/11.60 (LexisNexis 2005) (failing to include language referring to subsidiary asset sales); N.J. STAT. ANN. § 14A:10–11 (West 2003) (considering subsidiary asset sales but failing to distinguish between wholly owned and partially owned subsidiaries); N.Y. BUS. CORP. LAW § 909 (McKinney 2003) (failing entirely to reference subsidiary asset sales); OHIO REV. CODE ANN. § 1701.76 (West 2009 & Supp. 2012) (containing similar language to DGCL Section 271, but failing to contemplate partially owned subsidiaries); TEX. BUS. ORGS. CODE ANN. § 21.455 (West 2012) (failing to consider asset sales through subsidiaries of any type).

²¹³ For an in-depth discussion of the differences between the Delaware and California approaches to fiduciary duties, see Charles E. Harrell & Joel N. Ephross, *Corporate Governance Feature: The Disney Decision and Distinctions Between Officers' and Directors' Fiduciary Duties Under Delaware and California Law*, 11 M&A LAW. 6 (2007) (detailing California's stricter fiduciary standards compared to Delaware's).

²¹⁴ See CAL. CORP. CODE § 1001 (West 1990 & Supp. 2014).

²¹⁵ See Hamermesh, *supra* note 79 (noting that, at the time of writing, the revenue from corporate franchise taxes averaged over 20% of the state's budget).

²¹⁶ See Hamermesh, *supra* note 11, at 1756 (describing the Council's timeline for considering and proposing changes to the DGCL, which typically spans only seven or eight months).

²¹⁷ This would comport with the legislature's aversion to creating "detailed regulatory prescriptions." See Hamermesh, *supra* note 79, at 414.

it currently places needless risk on shareholders and, as a result, should be amended. By applying the shareholder protections of Section 271 to sales through partially owned subsidiaries, the section will be brought in line with the underlying purpose of the DGCL, which is to protect shareholders within a legal regime of corporate autonomy and private ordering.²¹⁸ The Delaware legislature could effect a major change in a simple way and, in doing so, would guarantee some forward-looking legal predictability for practitioners and the Court of Chancery. Amending Section 271 in this way would cause corporations a relatively minor inconvenience in the future, but it would allow shareholders to breathe a significant sigh of relief and Delaware's judiciary to continue to apply the DGCL in an even-handed, textually faithful manner.

CONCLUSION

Section 271 of the Delaware General Corporation Law was amended in 2005 to protect shareholders against corporate boards eager to sidestep shareholder approval requirements by selling all or substantially all of the consolidated corporation's assets through a wholly owned subsidiary. But by choosing to omit language addressing asset sales through partially owned subsidiaries, the Delaware legislature left open a loophole that presents a remaining opportunity for corporations to circumvent Section 271's shareholder approval requirement. This loophole advances Delaware's commitment to private ordering and transactional efficiency, but it also exposes shareholders to considerable risk of corporate opportunism and disenfranchisement in contradiction to Section 271's inherent purpose. Section 271 should be amended. Although the Delaware Court of Chancery normally would be the first tasked with balancing law and equity in addressing this loophole, it will be more efficient for the legislature to reexamine and amend Section 271 in an effort to restore predictability before the workaround leads to litigation. In any event, if and when Section 271's loophole comes to the forefront, the provision will be reviewed according to the time-tested jurisprudential and legislative approach that has reinforced Delaware's position as the nation's standard-bearer in corporate law; a predictable and consistent legal regime ultimately will emerge.

²¹⁸ See Hamermesh, *supra* note 11, at 1784.