

# *Weinburger v. UOP:* Analysis of a Dissent

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*This article examines the dissent of Justice Duffy in the now withdrawn Delaware Supreme Court opinion of Weinberger v. UOP, Inc. which affirmed the lower-court decision and ruled that a cash-out merger whereby a parent company bought out the minority shareholders of a subsidiary was permissible.\*\* The court concluded that the price was fair, there was a proper purpose for the transaction, and that the investment banking firm that was paid by the parent company had no fiduciary duty to the minority and, absent a showing of a conspiracy, was not liable for damages.*

## **The Legality of Cash-Out Mergers**

What the law is, has become an increasingly difficult question to answer as the Delaware Supreme Court continues to render decisions governing the legality of cash-out mergers. The latest attempt to lay down a rule in this area, *Weinberger v. UOP, Inc.*,<sup>1</sup> involved the following facts:

Following a merger between UOP, Inc., a corporation in which The Signal Companies, Inc. had held a majority interest and Sigco Incorporated, a wholly owned subsidiary of Signal, the plaintiff, a former minority shareholder of UOP who was cashed out, brought suit. . . . After lengthy . . . proceedings, the Vice Chancellor, in an exhaustive decision entered judgment for the defendants.<sup>2</sup>

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\*\* Reargument in this matter has been granted and held. Justice Duffy, whose opinion is analyzed in this article, has retired. That opinion (as well as the footnote in note 22 *infra*) has been withdrawn by the court.

<sup>1</sup> Slip op. (Feb. 9, 1982).

<sup>2</sup> *Id.* at 2.

### The Weinberger Majority Opinion

The decision rendered by McNeilly and Quillen, for the majority, seems clear and to the point. "Basically," they note, "as to the contentions raised on appeal, we find no reason to justify reversing the final conclusions of the Vice Chancellor."<sup>3</sup> Although the majority did "find it desirable to focus our attention briefly on two of the multiple issues raised, the status of the investment banking firm of Lehman Brothers Kuhn Loeb Incorporated and the fairness of the \$21.00 price per share paid the cashed out UOP minority,"<sup>4</sup> it took only two and one-half double-spaced typed pages to arrive at the conclusion that "[t]he judgment of the Court of Chancery is affirmed."<sup>5</sup>

### The Weinberger Dissenting Opinion

In dissent, Justice Duffy sees:

"this case [as presenting] to the Delaware Courts important issues involving the responsibility of an investment banking firm, in the context of a corporate merger, and the fairness of the price paid by a dominant majority stockholder to the minority (public) stockholders who were squeezed out of the enterprise by the merger."<sup>6</sup>

Focusing on the fact that "Lehman Brothers had been paid by UOP the sum of '\$150,000 for the services rendered in connection with the preparation and delivery of' its opinion as to whether the merger was fair to the public stockholders,"<sup>7</sup> Duffy argues that "there is at least enough [evidence] in the case to require a trial on the issue of reasonable care or competence [on the part of Lehman Brothers]."<sup>8</sup>

Duffy's disagreement with the assessment of fairness made by Lehman Brothers and accepted by the trial court is based on their failure sufficiently to recognize

the benefit flowing to Signal "as a result of becoming the 100 percent owner" of UOP. . . . [This] benefit accruing to Signal as a result of the merger was real because, under Delaware law, the

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at 5.

<sup>6</sup> *Id.* at 6.

<sup>7</sup> *Id.* at 8 (footnote).

<sup>8</sup> *Id.*

"stockholders of a corporation are the equitable owners of its assets". . . . And upon liquidation, the stockholders are entitled to a pro rata share of net assets."<sup>9</sup>

As a result of the merger which Signal had caused, the public stockholders were forced out of UOP and Signal acquired the equitable ownership of UOP assets which had been owned by the stockholders it cashed out. . . . In short, as far as the public stockholders were concerned, the mechanics were merger in form but liquidation in fact.<sup>10</sup>

Duffy, in other words, would not accept the vice-chancellor's conclusions. He begins his dissent, however, by noting that "I agree with much that the Vice Chancellor wrote in explaining his understanding of the prior law announced by this Court,"<sup>11</sup> a statement made remarkable by the fact that it is precisely on matters of law (as opposed to findings of fact) that an appellate court is justified in replacing the trial court's views with its own.

### The Singer and Tanzer Decisions

The reference is presumably to the dilemma posed by the first two Delaware decisions attempting to delineate guidelines governing the legality of cash-out mergers. *Singer v. Magnavox Company* held that use of the merger process for no purpose other than to eliminate the minority interests for cash, regardless of the amount paid therefor, is a violation of the fiduciary duty owed by a majority shareholder to the minority.<sup>12</sup> In *Tanzer v. International General Industries, Inc.*, however, the same three judges (Hermann, Duffy, and McNeilly) held that a cash-out merger is permissible if the purpose is to further the interests of the majority shareholder, provided that the purpose is not merely a subterfuge to enable the majority shareholder to rid itself of the unwanted minority.<sup>13</sup>

The vice-chancellor in this case reconciled these decisions by noting that, in *Singer*, "proof of a purpose other than . . . minority freezeout

<sup>9</sup> *Id.* at 9.

<sup>10</sup> *Id.* at 10.

<sup>11</sup> *Id.* at 6.

<sup>12</sup> *Singer v. Magnavox Co.*, 380 A.2d 969 (Del. 1977).

<sup>13</sup> *Tanzer v. International Gen. Indus., Inc.*, 379 A.2d 1121 (Del. 1977).

does not end the matter and there still must be a hearing under the standard of *Sterling*," and that under *Tanzer*, "even if the purpose is *bona fide*, there still must be a hearing under the standard of *Sterling*, and at such a hearing it is not sufficient to limit the issue to price alone. Rather, price must be considered along with any other relevant factors."<sup>14</sup>

Insofar as Duffy's dissent is based on the possibility that the price was not shown to be fair, his analysis of the vice-chancellor's findings rests on the proposition that the transaction should be treated (from the minority shareholder's point of view) as "merger in form but liquidation in fact"<sup>15</sup> :

Net cash value was given little weight by Signal's expert because "there was no plan of its [UOP's] liquidation," 426 A.2d at 1362, and the Trial Court accepted that conclusion. As I read that ruling, the Court held that fairness to the minority was determined, not by an objective standard but by what Signal had *not* planned at the time of trial. And that is a rather strange approach. Signal can, of course, come up with a plan of liquidation when it wants to.<sup>16</sup>

Given that focus, Duffy's agreement with the vice-chancellor's reading of the law announced by prior decisions is especially troublesome, since the analysis of *Singer* and *Tanzer* stressed the central importance of the standards set out in the *Sterling* opinion.

#### A Look at *Sterling v. Mayflower Hotel Corporation*

*Sterling v. Mayflower Hotel Corporation*,<sup>17</sup> a 1952 decision by the Delaware Supreme Court, involved an action by a minority shareholder seeking to enjoin the merger (share for share rather than cash) of a subsidiary into its parent because the "majority stockholder . . . occup[ied], in relation to the minority, a fiduciary position in dealing with [the corporation]'s property."<sup>18</sup> The basis on which the trial court (whose action was affirmed in *Sterling*) concluded that the value of the exchange was fair was the report from the financial adviser on the basis of which the majority stockholder's directors had acted. The Delaware

<sup>14</sup> *Weinberger v. UOP, Inc.*, 426 A.2d 1333, 1344 (Del. Ch. 1980).

<sup>15</sup> See text at note 10 *supra*.

<sup>16</sup> Slip op. at 10 (footnote).

<sup>17</sup> 93 A.2d 107 (Del. 1952).

<sup>18</sup> *Id.* at 109-110.

Supreme Court rejected the arguments advanced by the *Sterling* plaintiffs as to why the exchange value should be considered unfair:

If plaintiffs' contention should be accepted it would follow that upon every merger of a subsidiary into its parent corporation that involves a conversion of the subsidiary's shares into shares of the parent, the market value of the parent stock issued to the stockholders of the subsidiary must equal the liquidating value of the subsidiary's stock. On its face this proposition is unsound, since it attempts to equate two different standards of value. In the case of many industrial corporations, and also in the instant case, there is a substantial gap between the market value and the liquidating value of the stock; and to apply to the merger of such corporations the proposition advanced by plaintiffs would be to bestow upon the stockholder of the subsidiary something which he did not have before the merger and could not obtain—the liquidating value of his stock.<sup>19</sup>

Duffy cannot, therefore, mean that he agrees with the vice-chancellor that *Sterling* establishes as a matter of law the proposition that, in an attack on the fairness of the value received by minority shareholders in a merger, the liquidating value of the corporate property can justifiably be ignored. His meaning must be that, while he agrees with the vice-chancellor about the importance of *Sterling* as a precedent, he believes that that precedent must be read considerably more flexibly than was done either by the vice-chancellor or by McNeilly and Quillen for the majority.

Such a demand is not, on its face, unreasonable. Indeed, as lawyers know, any precedent can in fact be accommodated by a court that wishes not to overrule it, either by stressing more strongly an element that was considered only in passing in the earlier opinion, or by expanding the universe of the factors considered in arriving at the result. The price exacted by such shifts in the law is uncertainty about the applicable standard, but that uncertainty is necessary if the law is to be effective as a control device, a successful attempt to influence behavior that has not yet occurred.

Thus, the clearer and more uniform a rule is, the more easily it is regarded as a formality that can justifiably be manipulated so long as compliance with its explicit formulation is maintained. It was presumably precisely this problem that the vice-chancellor had in mind in warning, when he dismissed the original *Weinberger* complaint, that a

<sup>19</sup> *Id.* at 111.

merger will not be made "immune from attack by the simple device of structuring the merger agreement so as to require that it be approved by a majority of the minority shareholders."<sup>20</sup> Because the merger attacked in *Weinberger* had been approved by a majority of the minority and because the vice-chancellor stressed that fact in his opinion dismissing the complaint, such approval began to be treated as mandatory for mergers attempting to comply with the standards laid down by the Delaware Supreme Court. One merger structured this way was attacked in *Harman v. Masoneilan Intern. Inc.*,<sup>21</sup> and the Delaware Supreme Court deferred issuing its opinion in that case to permit its issuance to coincide with the final *Weinberger* decision in order "to enable the Court to consider the relationship of the two decisions in the context of the prior decision of the Court of Chancery in *Weinberger*."<sup>22</sup> In *Harman*, Horsey with Duffy, and Quillen in concurrence, distinguished the initial *Weinberger* complaint from that in *Harman* by noting that it was only in the amended *Weinberger* complaint (which amended complaint resulted in the decision being affirmed by the supreme court) that it was "alleged that the majority shareholder has disseminated proxy materials to the minority shareholders that contained material misrepresentations as well as material omissions which tainted the minority's approval of the merger."<sup>23</sup>

It is on the basis of this distinction that the *Harman* court approves the original *Weinberger* dismissal. Thus, it argues that the original *Weinberger* "complaint was found not to state a *Sterling-Singer* fairness claim for breach of fiduciary duty because the majority shareholder was not charged with using its controlling position over the corporate machinery to accomplish the merger."<sup>24</sup> It thus reconciles the dismissal of the unamended complaint in *Weinberger* with its conclusion in *Harman* that "a complaint alleging breach of fiduciary duty by a majority stockholder in approving a merger allegedly fraudulent to the minority states a cause of action cognizable in equity when monetary relief is the only practicable remedy available and when defendants establish that the minority shareholders have themselves overwhelmingly approved the merger."<sup>25</sup>

<sup>20</sup> *Weinberger v. UOP, Inc.*, 409 A.2d 1267 (Del. Ch. 1979).

<sup>21</sup> 442 A.2d 487 (1982).

<sup>22</sup> *Id.* (footnote) (advance sheet).

<sup>23</sup> *Id.* at 495-496 (footnote).

<sup>24</sup> *Id.* at 495.

<sup>25</sup> *Id.* at 489.

### Examining the Judicial Panels

Because the *Harman* and *Weinberger* panels were different, the precise impact of *Harman* on the *Weinberger* analysis of the merits of a *Sterling-Singer* action remains unclear. Duffy dissented from the *Weinberger* opinion written by "McNeilly and Quillen . . . (for the majority),"<sup>26</sup> and, in *Harman*, Quillen "files a concurring opinion joining in the judgment,"<sup>27</sup> and Duffy joins the opinion by Horsey. The absence of McNeilly's views on the *Harman* situation is especially troublesome because his position is essential to an understanding of the impact of *Singer* and *Tanzer* on the meaning of *Sterling* as a precedent.

The panels in both *Singer* and *Tanzer* consisted of Duffy, McNeilly, and Hermann, and Duffy wrote the opinion in both cases. *Singer*, although handed down before *Tanzer*, appears in a later volume of the reporter, and McNeilly concurred in *Singer* on the basis that he "agree[d] with the holding . . . that a . . . merger, made for the sole purpose of freezing out minority stockholders, is an abuse of the corporate process" and that "it is my opinion that *Sterling v. Mayflower*, 93 A.2d 107 (1952), establishes an avenue for judicial scrutiny with a firm foundation based upon factual determinations of fundamental fairness and economic reasonableness which should be our guidelines for future cases."<sup>28</sup> The statement in the McNeilly concurrence, written when *Singer* was handed down, that does not appear in the reporter is that "[he was] inclined to think . . . that the [Duffy] opinion waffles in its attempt to establish guidelines for future merger litigation with emphasis on the coined phrase 'business purposes,' which standing alone connotes nothing magic or definite." One can only assume that, at the time his opinion was published, McNeilly had perceived a congruence between *Singer*, *Tanzer*, and the *Sterling* precedent that was not clear to him when *Singer* was handed down. If that assumption is correct, it is apparent that what underlies Duffy's dissent in the present case is his view that however McNeilly now accommodates the decision in *Weinberger* to what was said in *Sterling*, *Singer*, and *Tanzer*, something in the majority opinion in *Weinberger* is inconsistent with that congruence.

<sup>26</sup> Slip op. at 1.

<sup>27</sup> *Harman v. Masoneilan Intern. Inc.*, note 21 *supra*, at 489 (footnote).

<sup>28</sup> *Singer v. Magnavox Co.*, note 12 *supra*, at 982.

### Protecting the Minority Shareholders

Duffy's dissent proposes a trial on what he characterizes as a "question . . . of first impression in this Court, namely: does an investment banker who gives an opinion as to the value of stock, knowing that it will be used to help persuade minority public stockholders to transfer their shares to the majority stockholder at the price offered by the majority, owe any duty to the minority stockholders?"<sup>29</sup> The issue posed is not, of course, whether there is any duty at all. The question Duffy is raising is whether the fact that Lehman Brothers was paid by the majority stockholder requires the court to apply a high standard of reasonable care and competence in assessing the basis on which Lehman reached its conclusion as to fairness of price and in imposing liability in cases where that standard is not met.

That issue, on its face, is one appropriately referred to the processes of law. Thus, one of the functions our society entrusts to the law is that of preventing management from using its position to gain unfair advantage over the shareholders whose capital the corporate structure puts at the disposal of management. Effective performance of such a function is crucial to the workings of the economy in a free society, since control over capital will be relinquished to managers only if the processes of law continue to be perceived by those who control capital as capable of providing the necessary protection.

#### Perlman v. Feldman

It was in an attempt to provide such protection that the Second Circuit held, in *Perlman v. Feldman*,<sup>30</sup> that part of the premium received for control of a corporation had to be shared with the stockholders. What *Perlman* involved was sale at a premium above-market price of the controlling interest in a steel manufacturing plant shortly after the Korean War had begun to a corporation created for the purpose of the purchase by users of steel. In a public corporation, however, the question of the percentage of outstanding shares that constitutes control is often no easier to answer than the question of what value is fair in a merger transaction.

It should therefore come as no surprise that when the Second Circuit was faced with the need to define what it meant by control (and thus to give operational content to the law declared in *Perlman*) a three-judge

<sup>29</sup> Slip op. at 7.

<sup>30</sup> 219 F.2d 173 (2d Cir.) cert. denied 349 U.S. 952 (1955).

panel wrote three separate opinions, and agreed only that a trial was required in the district court.<sup>31</sup> The rule of law promulgated in *Perlman v. Feldman*, in short, was sufficiently vague that it served solely to expand the scope of judicial intervention in business affairs. The fiduciary standard on the basis of which a violation was found in *Perlman* was technically a matter of state law, but Rule 10b-5 provided the basis for a steady stream of opinions which had the same effect of expanding the scope of judicial intervention. Because Rule 10b-5 was issued under the authority of the Securities Exchange Act of 1934, moreover, such opinions placed exclusive jurisdiction in the federal courts.<sup>32</sup> It was in response to *Santa Fe Industries v. Green*,<sup>33</sup> an attempt by the U.S. Supreme Court to call a halt to this process, that *Singer* and *Tanzer* came before the Delaware courts.

#### Santa Fe v. Green

The holding in *Santa Fe* was that minority shareholders, dissatisfied with the terms of a merger consummated in accordance with statutory Delaware law, were restricted to the appraisal remedy provided by the state law in the absence of allegations of misrepresentation or lack of disclosure. Justice Brennan dissented on the basis adopted by the Second Circuit: that a Rule 10b-5 claim was stated by allegations that the majority was effecting a merger without any justifiable business purpose and that the proposed price to be paid for the shares was substantially lower than a price reflecting the appraised value of the physical assets.<sup>34</sup>

Part IV of the *Santa Fe* opinion noted:

In addition to posing a "danger of vexatious litigation which could result from a widely expanded class of plaintiffs under Rule 10b-5," *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 740 (1975), [the proposed] extension of the federal securities laws would overlap and quite possibly interfere with state corporate law.<sup>35</sup>

It concluded that "[t]here may well be a need for uniform federal fidu-

<sup>31</sup> *Essex Universal Corp. v. Yates*, 306 F.2d 572 (2d Cir. 1962).

<sup>32</sup> Section 27 of the Exchange Act gives the federal district courts "exclusive jurisdiction of violations of this title or the rules and regulations thereunder, and of all suits in equity and actions of law brought to enforce any liability for duty created by this title or the rules and regulations thereunder."

<sup>33</sup> 97 S. Ct. 1292 (1977).

<sup>34</sup> *Id.* at 1304.

<sup>35</sup> *Id.* at 1303.

ciary standards to govern mergers such as those challenged in this complaint. But those standards should not be supplied by judicial extension of §10(b)."<sup>36</sup> The basis for its holding was that "to the extent that Rule 10b-5 is interpreted to require a valid corporate purpose for elimination of minority shareholders as well as a fair price for their shares, it would impose a stricter standard of fiduciary duty than that required by the law of some States,"<sup>37</sup> and it was to test this view of state law (at least insofar as it was applicable to Delaware) that *Singer* and *Tanzer* were brought.

The process of expanding federal jurisdiction over corporate transactions undertaken by the Second Circuit has thus had, as one of its products, the substantive law embodied in *Weinberger*. Viewed from this perspective, it is clear that Duffy wants a more flexible reading of the *Sterling* precedent because the law established by *Weinberger* is that the question of the fairness of the price in a cash-out merger is to be treated by the appellate court as a matter of fact found by the trial court. The Duffy dissent, in other words, is a plea for the promulgation of rules of law, and the plea goes unanswered because the issues it raises go to the very core of what we mean by calling law what is in fact a process of courts adjudicating a succession of controversies.

Thus, the trial called for by the Duffy dissent represents a justifiable expenditure of resources only if the facts of *Weinberger* are sufficiently different from those of *Sterling*; only if the Delaware Supreme Court can justify, as a matter of law, distinguishing the *Lehman Brothers* opinion as to fairness of price in *Weinberger* from the *Sterling* opinion as to the fairness of the exchange of stock.<sup>38</sup>

### Will Duffy Be Proven Right?

The U.S. Supreme Court has transformed dissents by Mr. Justice Holmes into the constitutional law of the First Amendment. It is thus by no means impossible for the Delaware Supreme Court eventually to find inadequate the rules that were law when *Sterling* was decided, and to order the trial for which Duffy is arguing. The question such a holding would raise, however, is the extent to which such "flexibility" in reading precedents is consistent with the provision of operational guidelines, the extent to which standards contained in precedents such as *Sterling* could justifiably continue to be characterized as law.

<sup>36</sup> *Id.* at 1304.

<sup>37</sup> *Id.* at 1304 n. 16.

<sup>38</sup> See text following note 18 *supra*.