PARENTS AND SUBSIDIARIES IN DELAWARE: A DYSFUNCTIONAL STANDARD

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INTRODUCTION

The state of Delaware arguably has the most developed body of corporate common law jurisprudence,[1] including an abundance of case law dictating the appropriate application of fiduciary theories. However, when it comes to determining the fiduciary obligations which a parent owes to a less-than-wholly-owned subsidiary, Delaware law is somewhat muddled. The Delaware courts apparently apply one of two different standards to similar factual circumstances. Section I of this paper outlines the most significant Delaware decisions regarding parents and less-than-wholly-owned subsidiaries in order to explain the courts' analysis in these cases. Section II articulates a suggestion for resolving and clarifying the case law. Finally, Section III provides pragmatic suggestions for practitioners to use when approaching a parent-subsidiary analysis under the current indeterminate state of the law.

I.
BACKGROUND LAW

A. *Fiduciary Duty – The Case Law*

Before exploring the development of Delaware case law regarding fiduciary obligations in the parent-subsidiary context, a basic discussion of fiduciary duty law is appropriate. It is a generally understood aspect of American corporate juris-

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1. Delaware corporate law has been at times elevated and at times derided by academics as alternately the most well developed expression of corporate jurisprudence and the best example of a governmental race to the bottom in an effort to satisfy corporate consumers. *See generally* Louis K. Liggett Co. v. Lee, 288 U.S. 517, 557-60 (1933) (describing the race to bottom caused by lesser states eager for corporate charter revenue); Henry N. Butler and Larry E. Ribstein, *Opting Out of Fiduciary Duties: A Response to the Anti-Contractarians*, 65 WASH. L. REV. 1, 69 (1990) (mentioning a description of Delaware as the winner of the race to the bottom).

prudence that corporate directors owe fiduciary duties to the corporation's shareholders.[2] The general rationale for the imposition of a fiduciary obligation on directors is that, due to agency problems, the cost of capital would be excessively high if investors lacked confidence that managers would make decisions in accordance with the investors' best interests.[3] However, under Delaware law, the mere imposition of a fiduciary obligation does not necessarily imply that a court will overturn any management decision which ends up harming shareholders. In fact, the directors of a corporation are generally protected from judicial interference in the management of the business by the business judgment rule. This standard, described below, insulates directors from judicial interference unless certain conditions are met which require the court to instead engage in the more exacting "entire fairness" analysis.[4]

The business judgment rule is "a presumption that the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company."[5] The business judgment rule is generally granted considerable deference by Delaware judges, based at least in part upon an understanding that the presumption protects companies' everyday business decisions from judicial interference. Although it does not protect directors from liability in cases of gross negligence or self-dealing, the business judgment rule often insulates directors from having to pay damages, even if their decisions were unwise or caused a loss to shareholders or the company.[6] The protec-

2. *See* Stefan J. Padfield, *In Search of a Higher Standard: Rethinking Fiduciary Duties of Directors of Wholly-Owned Subsidiaries*, 10 FORDHAM J. CORP. & FIN. L. 79, 98 (2004) (stating that corporate directors owe fiduciary duties to shareholders).

3. *Id.*

4. It should be noted that a third standard has also developed, that of heightened scrutiny. This intermediate standard is applied to decisions by boards of directors in the takeover defense context. *See id.* at 100 (describing the imposition of the modified business judgment rule); *See generally* Unocal Corp. v. Mesa Petroleum, 493 A.2d 946 (Del. 1985) (describing the *Unocal* two-step test and the application of the modified business judgment rule).

5. Smith v. Van Gorkum, 488 A.2d 858, 872 (Del. 1985).

6. *See* MATTHEW BENDER, 1-15 DELAWARE CORPORATE LAW AND PRACTICE § 15.03 (2005) (absent a finding of the breach of particularly articulated standards of behavior, directors will not be held liable "even if the decision

tions afforded by the business judgment rule can be overcome by a plaintiff who shows that a director (or controlling shareholder/parent) has engaged in self-dealing.[7] Upon such a showing, the court reviewing the alleged misconduct will apply a heightened level of scrutiny. In the context of parent-subsidiary relations, the standard applied is termed "entire fairness."[8]

The entire fairness test is an enhanced scrutiny standard whereby Delaware courts specifically evaluate the validity of a company's decisions. Delaware courts have found that the entire fairness test consists of two prongs: fair price and fair dealing.[9] The court in *Weinberger v. UOP* explained entire fairness as follows:

> The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock.[10]

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appears to have been unwise or have caused loss to the corporation or its stockholders").

7. *See id.* (stating that the business judgment rule may be overcome by a showing that, among other things, the defendant engaged in self-dealing).

8. *See id.* at § 15.05.

> The most frequently invoked "exception" to the business judgment presumption is directorial self-dealing or interest. A prima facie showing that a corporate decision conferred a benefit, directly or indirectly, upon a majority stockholder or upon the directors whose participation in the decision was necessary for its effectiveness, or that some special non-pro rata advantage was derived by a majority stockholder or a majority of directors from a corporate failure to act, is sufficient of itself to rebut the presumption and bring the special rules applicable to self-dealing transactions into play.

9. *See* Weinberger v. UOP, Inc., 457 A.2d 705, 711 (Del. 1983) (describing entire fairness as enhanced scrutiny and articulating the fair price and fair dealing prongs of the analysis).

10. *Id.*

Although the entire fairness test is considered part of a heightened standard, the difference between business judgment and entire fairness is more a difference in kind than a difference of degree. In Delaware corporate law, the application of the business judgment rule or the entire fairness test is often outcome determinative "[b]ecause the effect of a proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting."[11] As a result, the question of which standard will apply is often the centerpiece of litigation.

In cases involving a parent and a less-than-wholly-owned subsidiary, the Delaware Supreme Court holding of *Sinclair Oil Corp v. Levien* dictates that the entire fairness test should be applied where

> [A] parent by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of, and detriment to, the minority stockholders of the subsidiary.[12]

However, some Delaware courts have disregarded *Sinclair* and applied the exacting entire fairness standard upon a finding that a parent company stood on both sides of a transaction with a subsidiary.[13] The rest of this section is devoted to clarifying the doctrine of parent-subsidiary relationships, as defined by *Sinclair*, and to describing the various ways in which subsequent courts have applied it.

1. Sinclair v. Levien

Commentators suggest that the genesis of the Delaware case law on parent-subsidiary fiduciary duties can be traced to

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11. Unitrin Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1371 (Del. 1995) (citing Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1989)).

12. Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).

13. *See, e.g.*, Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 500 (Del. Ch. 1990) (asserting that the conduct of the majority stockholder standing on both sides of the transaction must be evaluated in accordance with the "entire fairness" standard); *In re* Maxxam, Inc., 659 A.2d 760, 771 (Del. Ch. 1995) (stating that where a shareholder controls a company and stands on both sides of a transaction the burden rests with that shareholder to show that the transaction was entirely fair).

Sinclair.[14] In *Sinclair*, the plaintiff, a minority stockholder of one of Sinclair's subsidiaries, Sinven, sued for damages based upon Sinclair's alleged breach of its fiduciary duty to its minority shareholders. Sinclair was, in essence, a holding company in the business of exploring for oil and producing and marketing oil products. Sinclair was a 97% holder of Sinven, which had been incorporated in 1922 and had operated exclusively in Venezuela from 1959 forward. Sinclair nominated all of the members of Sinven's board, and the lower court found as a matter of fact that these directors were not independent of Sinclair.[15] When discussing the composition of Sinven's board, the court stated that "[a]lmost without exception [the board members] were officers, directors, or employees of corporations in the Sinclair complex."[16]

The *Sinclair* court cited *Getty Oil*[17] for the proposition that when a parent company dominates a subsidiary it owes a fiduciary obligation to that subsidiary. As an initial matter, the finding of a fiduciary relationship was clearly significant in *Sinclair*. Without the legal hook of a fiduciary obligation, no cause of action would be available to the plaintiff under Delaware's corporate jurisprudence. Although the finding of a fiduciary obligation created a basis for the plaintiff's claim, that claim would have had little chance of success if the court chose to apply the business judgment rule.

In overturning the Chancery court's determination that entire fairness applied because Sinclair controlled Sinven, the Supreme Court of Delaware held that although Sinclair clearly owed a fiduciary obligation to Sinven, that duty would be evaluated under the entire fairness standard only upon a particular showing of facts. In the court's own words,

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14. *See* EDWARD P. WELCH & ANDREW J. TUREZYN, FOLK ON THE DELAWARE GENERAL CORPORATION LAW: FUNDAMENTALS § 141.2.7 (2006 ed.) (describing *Sinclair* as one of the authoritative Delaware Supreme Court decisions on the issue of parent fiduciary duties); Mary Siegel, *The Erosion of the Law of Controlling Shareholders*, 24 DEL. J. CORP. L. 27, 29 (describing *Sinclair* as the case which articulated the test for when courts will demand a fairness review of parent company decisions); A. Gilchrest Sparks, III & Frederick H. Alexander, *The Delaware Corporation: Legal Aspects of Organization and Operation*, 1-4th C.P.S. (BNA) § III-I (2004) (citing *Sinclair* as the authority for the fiduciary duty owed by a parent to a subsidiary).

15. *Sinclair*, 280 A.2d at 719.

16. *Id.* at 719.

17. Getty Oil Co. v. Skelly Oil Co., 267 A.2d 883, 886 (Del. 1970).

> A parent does indeed owe a fiduciary duty to its subsidiary when there are parent-subsidiary dealings. However, this alone will not evoke the intrinsic fairness standard. This standard will be applied only when the fiduciary duty is accompanied by self-dealing – the situation when a parent is on both sides of a transaction with its subsidiary. Self-dealing occurs when the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something to the exclusion of, and detriment to, the minority shareholders of the subsidiary.[18]

This articulation of the circumstances under which entire fairness review is appropriate is notable for several reasons. First, the court rejects the possibility of holding parent companies up to the entire fairness standard with only a showing that the parent is standing on both sides of the transaction when dealing with its subsidiary.[19] Second, the court redefines self-dealing for the specific context of parent-subsidiary relations.[20] Finally, it is apparent that the court explicitly defines self-dealing in the parent-subsidiary context in order to ensure that courts do not substitute their own business judgment for that of the parent company where it is not appropriate. The implementation of this specific test suggests that the court was cognizant of the ease with which corporations can satisfy the business judgment rule and the difficulty of satisfying the entire fairness test.[21] The implementation of this additional test is an attempt by the court to take a middle road.

The plaintiff in *Sinclair* alleged three separate breaches of Sinclair's fiduciary obligation to Sinven: (i) the purportedly improper nature of dividends paid by Sinven; (ii) the allegedly improper acts by Sinclair which hindered Sinven's growth and development; and (iii) the alleged prevention of Sinven from

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18. *Sinclair*, 280 A.2d at 720.

19. *Id.* at 722. The significance of this explicit rejection becomes apparent in the context of later case law which apparently explicitly ignores this aspect of the *Sinclair* holding.

20. *Id.* at 720.

21. *See generally* Siegel, *supra* note 14, at 51 (positing that the court's reasoning in *Sinclair* was "premised on concerns . . . about the deference accorded under the business judgment rule as well as the significant demands a fairness review imposes on courts").

pursuing a breach of contract claim between Sinven and one of Sinclair's wholly-owned subsidiaries, Sinclair International Oil Co. ("International").[22] The court evaluated each of these claims using the test articulated above (the "Sinclair Test") to determine whether Sinclair's actions constituted self-dealing and thus warranted entire fairness scrutiny.[23]

a. Improper Dividends

In the six year period from 1960 to 1966, Sinclair caused Sinven to pay out $108 million in dividends - approximately $38 million in excess of Sinven's earnings during that time.[24] After analyzing the declaration of these dividends, the court held that self-dealing had not occurred because the minority shareholders of Sinven had received a proportional distribution of the dividends from the arguably excessive dividend distributions.[25] The court noted that, although the dividends caused "great sums of money" to be transferred from Sinven to Sinclair (presumably causing a detriment to the minority shareholders), the minority shareholders were not *excluded* from the distribution. Having found that the exclusion element of the Sinclair Test as articulated above was not satisfied, the court applied the business judgment rule to the declaration of dividends and refused to interfere with the business judgment of the Sinven board.[26]

The court did, however, suggest a hypothetical situation in which it would have applied the entire fairness standard:

> If such a dividend is in essence self-dealing by the parent, then the intrinsic fairness standard is the proper standard. For example, suppose a parent dominates a subsidiary and its board of directors. The subsidiary has outstanding two classes of stock, X and Y. Class X is owned by the parent and Class Y by the minority shareholders of the subsidiary. If the subsidiary, at the direction of the parent, declares a dividend on its Class X stock only, this might well be self-dealing by the parent. It would be receiving

22. *Sinclair*, 280 A.2d at 719.
23. *Id.* at 720.
24. *Id.* at 720-21.
25. *Id.* at 721-22.
26. *Id.* at 722.

> something from the subsidiary to the exclusion of and detriment to its minority shareholders. This self-dealing, coupled with the parent's fiduciary duty, would make intrinsic fairness the proper standard by which to evaluate the dividend payments.[27]

b. Stunted Growth?

In considering Sinclair's policy of disallowing expansion at Sinven, the court similarly found that Sinclair received nothing to the exclusion of and detriment to the minority shareholders.[28] The court's conclusion was based upon its finding that the plaintiff had failed to put forth evidence of any business opportunities which had come to Sinven independently, and which Sinclair either had taken for itself or denied to Sinven. In other words, failure to promote expansion does not constitute self-dealing unless it is shown that the parent corporation misappropriated a business opportunity from its subsidiary. On this claim the court again invoked the business judgment rule and refused to interfere with the business judgment of Sinclair's directors.

c. Contract Breach

With respect to Sinclair's alleged refusal to allow Sinven to enforce a contract claim against International, the court found that Sinclair's actions did satisfy all the elements of the Sinclair Test. The contract dispute arose from an oil purchase agreement between Sinven and International, a wholly-owned subsidiary created by Sinclair for the purpose of coordinating Sinclair's foreign investments. Sinclair caused Sinven to agree to sell all of its oil to International at predetermined prices and International later breached the agreement. The court held that Sinclair had indeed received something to the detriment of Sinven's minority shareholders by allowing the breached contract to go unremedied. The court reasoned that, although Sinclair did not need to contract with its subsidiary, because it chose to do so and received a benefit from the contract, it could not simply ignore its contractual duties.[29] In

27. *Id.* at 721.
28. *Id.*
29. *Id.* at 723.

summary, Sinclair caused its dominated subsidiary to enter into a transaction from which it benefited to the exclusion of and detriment to the minority shareholders. As a result, the court applied the entire fairness test, found that Sinclair's actions did not pass muster under this test, and held that Sinclair had breached its fiduciary duty.[30]

2. *Subsequent Applications of the Threshold Test*

Although *Sinclair* was a Delaware Supreme Court decision, the application of its holding in later Delaware cases has been somewhat inconsistent.[31] The subsequent case law on the issue of parent fiduciary duties can be divided into two categories. The first category consists of cases that follow *Sinclair* or deviate from it in a relatively insignificant way. The second category includes cases where courts have disregarded *Sinclair* and applied entire fairness to situations involving parent-subsidiary relationships solely upon a finding that a parent has stood on both sides of a transaction.

3. *The Source of the Two Categories*

The source of confusion in Delaware case law over the application of *Sinclair* apparently stems from the Delaware Supreme Court holding in *Weinberger v. UOP, Inc.*[32] *Weinberger* involved an attempt by a company called Signal Corp., which had previously acquired 50.5% of UOP, to acquire the remaining 49.5%. Before engaging in discussions with UOP's outside directors, Signal received a study from two *inside* UOP board members (Arledge and Chitea) which, using UOP data, found that any price up to $24 per share would be a good deal for Signal. This study was never disclosed to UOP's independent directors or shareholders before Signal made an offer of $21 per share. It is interesting to note, as the court pointed out, that this $3 per share price differential amounted to a difference in profits to Signal of only .02%. However, the higher

30. *Id.* In evaluating the actions of Sinclair in light of entire fairness, the court did not engage in the in-depth analysis of cases that post-date *Weinberger*'s entire fairness analysis because *Sinclair* predates *Weinberger*.

31. *See* Siegel, *supra* note 14, at 31 (stating that "[t]he undermining of *Sinclair* has relegated the bulk of transactions involving controlling shareholders for review under the entire fairness standard").

32. Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

price would have meant an additional $17 million in returns for the minority shareholders of UOP.

In evaluating the transaction, the *Weinberger* court held that where a parent stands on both sides of a cash-out merger with a less-than-wholly-owned subsidiary, the majority shareholder must prove by a preponderance of the evidence that the transaction was entirely fair to the subsidiary.[33] The court also noted that the initial burden rests with the plaintiff to plead some basis for invoking the parent company's fairness obligation.[34] Although the court noted that an informed vote of a majority of disinterested shareholders (a "Cleansing Act") could serve to shift this burden of proving entire fairness (or the lack thereof) to the plaintiff, there was no possibility of such a shift in *Weinberger* because the failure to disclose the Arledge and Chitea analysis had negated the possibility of an informed vote.[35] It is important to highlight that the court stated that a Cleansing Act would shift the burden of proof on entire fairness but did not suggest that it would return the court to a business judgment standard. The court's approach reflects the notion that parent-subsidiary mergers are so ripe with conflicts that the business judgment rule may be too lenient a standard. This reasoning, although entirely sensible in the parent-subsidiary merger context, could prove problematic if extended beyond that context. This is discussed further in Section II.

In its analysis of the parent company's fiduciary obligation to its subsidiary in the merger context, the *Weinberger* court essentially disregarded the *Sinclair* decision. Although it is reasonable to conclude that the court ignored *Sinclair* because there was a separate line of cases handling cash-out mergers,[36] it is odd that the court did not even seek to distinguish *Sinclair*. The court in *Weinberger* cited *Sinclair*, but only for the proposition that a fiduciary duty is owed to both corporations when an

33. *Id.* at 703.

34. *Id.*

35. *See id.*

36. Although the line of cases dealing with fiduciary obligations in the merger context is not discussed in great depth in the Delaware Supreme Court's decision, the Chancery court opinion devoted considerable time to an analysis of the previous case law. *See* Weinberger v. UOP, Inc., 426 A.2d 1333, 1342-46 (Del. Ch. 1981).

individual holds a dual directorship.[37] Of course, in a parent-subsidiary merger, the result of the *Sinclair* analysis is a foregone conclusion. Entire fairness will always apply. However, as evidenced by the following discussion, this failure to distinguish *Sinclair* has led to some confusion amongst the lower courts.

Perhaps Delaware case law could have followed *Weinberger* under the assumption that the *Weinberger* court had meant to overrule *Sinclair*. However, one year after *Weinberger*, the Delaware Supreme Court reaffirmed the validity of *Sinclair* in *Gabelli & Co. v. Liggett Group Inc.*[38] *Gabelli* involved a class action brought by a minority stockholder to compel the payment of a dividend on the theory that the majority stockholder had breached its fiduciary duty to the minority stockholders. The plaintiff claimed that the defendant caused the corporation to refrain from declaring a dividend solely for the purpose of enabling the majority stockholder to obtain the dividend for itself after a merger of the corporation with a wholly-owned subsidiary and a cash-out of the minority stockholders.[39]

The plaintiff in *Gabelli* represented a class composed of the 13% of Gabelli's original shareholders who had chosen not to tender their shares in the Ligget Group's initial offer. The tender offer had disclosed the acquirer's intention to cash out the non-tendering minority at the tender offer price of $69 per share (roughly a 40% premium over the prevailing market price). The plaintiff complained of the failure to pay a quarterly dividend that had been paid regularly in the past. In response to the plaintiff's assertion that the *Sinclair* analysis applied to the failure to declare a traditionally declared dividend, the court concluded that there was no self-dealing under the Sinclair Test. The court reasoned that under prevailing Delaware law the minority holders of a company have no established right to the declaration of a dividend and, therefore, they cannot suffer a detriment in the absence of such a declaration.[40] Consequently, the detriment element of

37. *See Weinberger*, 457 A.2d at 710.

38. *See* Gabelli & Co. v. Liggett Group Inc., 479 A.2d 276, 281 (Del. 1984).

39. *Id.* at 277.

40. *See id.* at 281.

the Sinclair Test was not satisfied and entire fairness did not apply.

Just as *Weinberger* disregarded *Sinclair*, *Gabelli* disregarded *Weinberger*. The facts of *Gabelli* lend themselves to analysis under *Sinclair* for two reasons. First, the impact on the plaintiff of the refusal to declare dividends in *Gabelli* is quite distinct from the impact of the inadequate price offered in *Weinberger*. Second, *Sinclair* explicitly addressed the issue of dividends in dicta, so the application of *Sinclair* seems appropriate.

As mentioned earlier, the *Sinclair* court provided an example of when a dividend distribution might warrant entire fairness review. Suppose a subsidiary has two classes of stock, X and Y. Class X is owned by the parent and class Y is owned by the minority shareholders of the subsidiary. The parent's decision to direct the subsidiary to declare a dividend on the class X stock only could be considered self-dealing by the parent because it would be receiving a dividend to the exclusion and detriment of the minority shareholders.[41]

All three cases involve the fiduciary obligation owed by a parent to its subsidiary where the parent company is clearly standing on both sides of a transaction. It is confusing that the Delaware Supreme Court seemingly glossed over its own decisions, especially when the *Weinberger* and *Gabelli* decisions came less than 15 months apart.

The *Weinberger* court's failure to address *Sinclair*, and the *Gabbelli* court's failure to address *Weinberger* have forced subsequent courts, commentators, and practitioners to speculate as to the courts' reasoning in these cases. The remainder of this section is devoted to describing the subsequent case law. Section 4 below describes the subsequent cases applying *Sinclair*. These cases speak to the ongoing validity of at least some aspects of *Sinclair*'s holding. Section 5 provides examples of cases which have followed *Weinberger*.

4. *Cases Following* Sinclair

a. The Howard Hughes Shuffle

One of the most difficult post-*Weinberger* parent-subsidiary analyses by the Delaware Supreme court appears in *Summa*

41. *Sinclair*, 280 A.2d at 721.

Corp. v. Trans World Airlines Inc.[42] Toolco (later renamed Summa) was an entity wholly owned and controlled by Howard Hughes. Toolco generally behaved in a manner which the court characterized as detrimental to its less-than-wholly-owned TWA subsidiary, apparently in large part due to "Hughes' evasive nature and difficult temperament."[43]

According to the court, Toolco created problems for TWA and generally behaved poorly by: (i) refusing to allow TWA to purchase jets directly (i.e., not through Toolco); (ii) delaying the delivery of ordered jets; (iii) irrationally rejecting acceptable aircraft; (iv) forcing TWA to lease aircrafts instead of purchasing them; (v) selling airplanes to TWA at a profit; (vi) fixing lease terms and sales to TWA so that Toolco accrued capital gains and tax benefits; and (vii) structuring transactions with TWA so as to minimize its own exposure at the expense of TWA's profits.[44] The court found all of these practices to be materially detrimental to the productivity and effectiveness of TWA, but beneficial to Toolco.[45]

In applying existing precedent to evaluate Toolco/Summa's actions, the court failed to acknowledge the differences between *Sinclair* and *Weinberger*, and appears to have conflated the two decisions. In the court's own words:

> It is well established in Delaware that one who stands on both sides of a transaction has the burden of proving its entire fairness. *Weinberger v. UOP, Inc.*, Del. Supr., 457 A.2d 701, 710 (1983); *Sterling v. Mayflower Hotel Corp.*, Del. Supr., 33 Del. Ch. 293, 93 A.2d 107, 110 (1952). In the absence of arms length bargaining, clearly the situation here, this obligation inheres in, and invariably arises from the parent-subsidiary relationship. *Weinberger v. UOP, Inc.*, at 709, n. 7, 709-710; *Rosenblatt v. Getty Oil Co.*, Del. Supr., 493 A.2d 929, 937-38 (1985). This rule applies when "*the parent, by virtue of its domination of the subsidiary, causes the subsidiary to act in such a way that the parent receives something from the subsidiary to the exclusion of, and detriment*

42. *See* Summa Corp. v. Trans World Airlines Inc., 540 A.2d 403 (Del. 1988).

43. *Id.* at 405.

44. *Id.* at 407.

45. *Id.*

to the minority stockholders of the subsidiary." *Sinclair Oil*, 280 A.2d at 720 (emphasis in original).[46]

The court first stated the *Weinberger* rule, then stated the Cleansing Act burden-shifting process in the negative (simulation of arms-length bargaining), finishing the same paragraph by stating that the *Weinberger* rule applies when the Sinclair Test is satisfied. Having articulated the "standard" for analyzing this case, the court applied this standard to the facts discussed above and concluded that Summa must have violated its fairness obligations by accruing a benefit while its subsidiary suffered a detriment.

The court's analysis suffers from two problems. First, the court does not clearly articulate the manner in which it is applying the Sinclair Test. Most significantly, the court appears to ignore the exclusion prong of the Sinclair Test. Of course, the fact that TWA was excluded when Toolco benefited to TWA's detriment is arguably an obvious conclusion. At least one commentator has read the *Summa* decision as entirely ignoring the Sinclair Test as a prerequisite for determining whether the facts merited application of an entire fairness analysis.[47] However, a close reading of the case suggests that the court did in fact apply *Sinclair* as a preliminary test, but merely didn't articulate each step in the process. It is interesting to note that the author of the only lengthy academic treatment of this topic in the last ten years, was misled by the *Summa* court's analysis. By engaging in this sort of implicit analysis, the court has managed to confuse some very competent commentators.[48]

The second problem with the court's analysis is that it conflates the detriment/exclusion prong of *Sinclair* with an entire fairness analysis. The court uses the failure to satisfy the detriment/exclusion prong as conclusive evidence that the transaction was not entirely fair. The court does not engage in a lengthy fairness analysis, but rather declares the unfairness of the transactions as factually obvious. This is again troubling for those trying to carefully decipher the court's reasoning, but because Toolco had been involved in litigation for the bet-

46. *Id.* at 406-07.

47. *See* Siegel, *supra* note 14, at 60-62.

48. *See id.*

ter part of the century, the court was likely familiar with Toolco's practices.

b. The MGM Meltdown

Another example of a somewhat muddled application of *Sinclair* is the holding in *Jedwab v. MGM Grand Hotels, Inc.*[49] In *Jedwab*, the majority owner of the MGM Grand Hotel chain ("MGM"), Kerkorian, wanted to sell MGM to a third party. The court evaluated the consideration to be received by Kerkorian, and found that the only problematic element was Kerkorian's acceptance of the right to receive part of certain insurance claims. In 1980, the original MGM Grand Hotel had been the victim of a particularly vicious fire. The insurance claims were still pending, and the court found that the total insurance recovery could amount to as much as $85 million. Kerkorian was to receive, as part of his merger consideration, any recovery in excess of $59.5 million. Consequently, the court found that he could receive as much as $25 million from his right to the insurance claims.[50]

The court stated that it was applying the *Sinclair* analysis and then found that entire fairness should apply because "in apportioning [an] element of consideration wholly to his own shares to the exclusion of others Kerkorian was exercising power of a kind and in circumstances justifying invocation of the heightened standard of judicial review [entire fairness]."[51] The subtle difference between this analysis and the original *Sinclair* analysis is that the court seemingly holds for an application of the entire fairness test based upon a finding that Kerkorian's actions were exclusionary. The detriment prong of the test is not mentioned in the opinion.

At least one commentator has viewed the omission of the detriment prong in *Jedwab* as evidence that the Sinclair Test has been diluted by the Delaware courts.[52] However, there is a better way of explaining the court's omission of the detriment prong. Simply put, it was plainly obvious from the facts that the minority shareholders would suffer a detriment if they

49. 509 A.2d 584 (Del. Ch. 1986).

50. *Id.* at 596.

51. *Id.*

52. *See* Siegel, *supra* note 14, at 66 (stating that subsequent case law including *Jedwab* has diluted the *Sinclair* Threshold Test).

were excluded from receiving rights to the insurance claims. Indeed, whenever someone is excluded from a benefit that he or she was otherwise *entitled to*, such exclusion is to his or her detriment.

The confusion caused by the *Summa* and *Jedwab* decisions illustrates one of the problems with the original formulation from the *Sinclair* decision – namely that exclusion and detriment are concepts too similar to be kept cognitively separate under many circumstances.

c. The Wisdom of Solomon

In *Solomon v. Armstrong*,[53] the Delaware Court of Chancery analyzed General Motors' dealings with stockholders of one of its subsidiaries. GM was seeking to split off its subsidiary EDS. EDS was "traded" publicly in the form of Class E GM stock – a so-called tracking stock. In order for the split off to occur, it had to be approved by the holders of the Class E stock. GM created a number of committees to address the terms of the proposed split-off, and the board ultimately recommended a one-for-one exchange of EDS stock for the tracking stock. The arrangement was ratified by each major class of GM stock, including the Class E tracking stock.[54] The plaintiffs claimed that the GM board had breached its fiduciary obligations to the Class E stockholders.

The court recognized that a tracking stock is a unique "equity instrument . . . characterized by a peculiar relation between the economic interest it represents and the basic governance and control over the underlying assets."[55] After discussing the basic aspects of fiduciary duty law in Delaware, the court engaged in a general discussion of when the entire fairness standard will be applied. Specifically, the court stated that the protections of the business judgment rule will not be available where: (i) a parent company merges with its less-than-wholly-owned subsidiary; and (ii) allegations of self-dealing are leveled at the parent.[56] In a footnote, the court quoted the Sinclair Test for the definition of self-dealing, and accepted *Sinclair* as the leading authority on parent-subsidiary

53. Solomon v. Armstrong, 747 A.2d 1098 (Del. Ch. 1999).
54. *Id.* at 1109.
55. *Id.* at 1111.
56. *Id.* at 1112 (citing *Sinclair*, 280 A.2d at 720).

mergers.[57] The court even acknowledged the competing line of cases which follow *Weinberger* by citing *Citron v. E.I. Du Point de Nemours & Co.*,[58] a case discussed in greater detail below. The court's analysis up to this point suggested it was taking a sensible approach to the *Sinclair/ Weinberger* conflict. However, the court then proceeded to cite *Weinberger* as the binding precedent on parent subsidiary mergers, noting that, "in a parent-subsidiary merger where the parent controls the subsidiary, and can thereby 'force' the merger, the standard of review is entire fairness and the burden of proof is on the sponsoring directors."[59] The court cites directly to *Weinberger* for this proposition and makes no mention of the more nuanced explanation of the legal standard applicable to parent-subsidiary dealings which it had provided a few short pages before.

Given that the *Solomon* court cites both *Weinberger* and *Sinclair* for the legal standard of review in the parent-subsidiary merger context, neither pronouncement is of much use because the standards are at least somewhat mutually exclusive. However, one important point can be gleaned from this opinion: the conflicting decisions of *Sinclair* and *Weinberger* have clearly led to a lack of clarity in the courts. There are two possible explanations for this apparent confusion. Either the Delaware courts are carelessly applying two truly different standards, or these two different standards do not lead to meaningfully different outcomes in most circumstances. As will be discussed in Section II, *infra*, the latter explanation is the more plausible one.

d. Speedway

In the most recent decision following *Sinclair*, the Delaware Chancery Court held that the Sinclair Test was the appropriate standard to apply in the context of a sale of property to a company's chairman, CEO, and majority shareholder.[60] This case did not involve a parent-subsidiary relationship, but it is analogous to that situation because a parent company is, by definition, a majority shareholder (and the courts some-

57. *Id.* at 1112 n.35.

58. *Id.* (citing *Citron*, 584 A.2d at 500 n.13).

59. *Id.* at 1116.

60. *In re* Speedway Motorsports, Inc., No. CIV.A. 18245-NC, 2003 WL 22400758, at *2 (Del. Ch. Oct. 14, 2003).

times consider parents and majority shareholders interchangeably).[61]

In *Speedway*, SDI had purchased a real estate asset that turned out to be a bad investment. Smith, SDI's chairman, CEO, and majority shareholder, agreed to take the bad asset off of SDI's hands. Not only did he agree to take the property, but he also agreed to pay back to the company any profit he might realize from the sale of the asset.[62] For his trouble, Smith was slapped with a lawsuit alleging that he breached his fiduciary obligations to SDI's minority shareholders.

In determining whether to apply entire fairness or business judgment to Smith's actions, the *Speedway* court looked to the *Sinclair* standard. The court said that in order for entire fairness to apply, "Smith, by virtue of his dominance of SDI, must have caused the company to act in such a way that he 'received something from [SDI] to the exclusion of, and detriment to, the minority stockholders.'"[63] The court found that the Sinclair Test was not satisfied because Smith's agreement to return any profits to the company foreclosed the possibility that he had received something to the detriment of the minority shareholders.[64] Of course, the facts also precluded a finding that he received something to the *exclusion* of the minority shareholders, but the court did not address this prong of the test.

It was sensible for the *Speedway* court to rely upon *Sinclair* as controlling precedent in deciding whether to apply entire fairness. The *Speedway* facts bore no resemblance to the kind of end-game merger transaction implicated by the holding in *Weinberger*, and indeed it would seem bizarre to apply *Weinberger* to a parent-subsidiary loan. Perhaps the court saw no need to distinguish *Weinberger* and *Sinclair* under the specific facts of *Speedway* because the applicability of *Sinclair* seemed obvious. However, as evidenced by the *Maxxam* case described below, some courts have applied *Weinberger* to facts totally unrelated to mergers. Absent the current inconsistency in the case law, such an application ordinarily would be unlikely.

61. *See generally* Siegel, *supra* note 14, at 38.

62. *Speedway*, 2003 WL 22400758 at *2.

63. *Id.* (quoting *Sinclair*, 280 A.2d at 720).

64. *Id.*

5. *Cases Not Following* Sinclair

As evidenced by the discussion above, the line of cases following *Sinclair* has become muddled over time. Having considered the most prominent cases following *Sinclair*, it is unclear at this point to what extent the reasoning of *Sinclair* has survived. The line of cases engaging in a fairness analysis upon a finding that the parent stood on both sides of the transaction does not provide much help in clarifying matters. Some of the cases following *Weinberger* have been helpful in that they have explicitly and carefully applied *Weinberger*'s reasoning to analogous factual circumstances involving parent-subsidiary mergers. However, some cases have confused the issue by following *Weinberger* in situations outside the merger context.

a. Citron

In *Citron v. Dupont*,[65] DuPont sought to merge with its less-than-wholly-owned subsidiary, Remington. When discussing what standard to apply, the court recognized that the "precise circumstances that will trigger entire fairness have not been consistently articulated in the Delaware cases."[66] Unfortunately, the court incorrectly described the Sinclair Test as holding that entire fairness should apply when a parent corporation stands on both sides of a transaction and dictates its terms.[67] The court went on to find the *Weinberger* standard applicable because it was the most recent decision of the Delaware Supreme Court in the parent-subsidiary merger context.[68] This reasoning ignores some of the subsequent case law, but at least the court recognized the problem in the conflicting case law and chose a coherent and sensible method of resolution.

However, the precedential value of the *Citron* decision is limited for two reasons. First, the court stated that *Weinberger* is the binding precedent for parent-subsidiary mergers, so the decision's clarification of the inconsistent Delaware cases is limited to that specific factual situation. Second, the court in *Citron* stated that the difference between *Weinberger* and *Sinclair* is that *Sinclair* requires a parent company to have *dictated* the

65. Citron v. Dupont, 584 A.2d 490 (Del. Ch. 1990).
66. *Id.* at 500.
67. *Id.*
68. *Id.*

terms of a transaction. Although that is surely one aspect of the *Sinclair* decision, it is not the major difference between *Weinberger* and *Sinclair.*

b. In re Maxxam

In re Maxxam[69] is another case where the Delaware Chancery Court followed *Weinberger,* but not simply because it postdates *Sinclair.* Instead, the court engaged in an unusual application of *Weinberger* to a factual situation in which other courts have applied *Sinclair.*

In *Maxxam,* Federated, Maxxam's controlling parent company, induced Maxxam to enter into loan agreements with Federated. Federated wanted these loans from Maxxam so that it could try to develop some high-end residential real estate in Southern California.[70] When it started to look like the real estate project was going sour, Federated had Maxxam buy the real estate from it.[71] The consideration paid by Maxxam for the real estate was at the high end of a valuation by Cushman and Wakefield, which was called into question by subsequent valuations.[72]

The court first dealt with the issue of the loans.[73] The court disregarded *Sinclair* and instead applied *Weinberger* in this situation, a situation that did not resemble a parent-subsidiary merger. The court held that the applicable standard of review for a parent-subsidiary loan was entire fairness where "a shareholder owing . . . fiduciary duties stands on both sides of a challenged transaction."[74] The court concluded that Federated was on both sides of the transaction as the loans were made from Maxxam to Federated. Consequently, "at a trial

69. *In re* Maxxam, 659 A.2d 760, 771 (Del. Ch. 1995).

70. *Id.* at 765.

71. *Id.* at 766-67.

72. *Id.*

73. It is important to note the procedural posture of the court. The court was reviewing the validity of a settlement to which the plaintiff objected. In order to determine the validity of the settlement, the court needed to reach the merits of plaintiff's claims that Federated breached its fiduciary obligations to Maxxam by engaging in the loan and sale of property transactions.

74. *Maxxam,* 659 A.2d at 771.

Federated would be required to demonstrate that the 1987 loan transactions were entirely fair."[75]

The court's treatment of the sale of land transaction is also troubling. The court not only failed to recognize that this type of transaction was different from the one involved in *Weinberger*,[76] but it also misapplied *Weinberger*. The court concluded that, as in the case of the loans, Federated had "stood on both sides of the challenged transaction."[77] Although the court did not explicitly state which standard it was applying the implication seems to be that the court was again applying *Weinberger*. It would be inconsistent to apply *Weinberger* to the loan but not the sale of property in the same decision. Although the court almost certainly applied *Weinberger*, it also engaged in a long discussion about the independence of the board's special committee, which had reviewed the sale of property. Apparently the court was trying to determine if the independence of the board could take the court back to an evaluation under business judgment. *Weinberger* specifically stated, however, that any form of independent affirmation of a transaction will only shift the burden of proof on entire fairness.[78]

Although it is not explicitly stated in the opinion, the court's reasoning seems quite sensible. The court in *Maxxam* probably found that the standard should revert to business judgment after a Cleansing Act because the transaction in *Maxxam* did not implicate the same concerns as the merger in *Weinberger*. Recall that the *Weinberger* court was concerned with the inherent conflicts of a parent-subsidiary merger when it said that entire fairness would apply even after affirmation by an independent committee.

Maxxam illustrates an important problem raised by the inconsistent application of *Weinberger* and *Sinclair* to parent-subsidiary dealings. If *Weinberger* is strictly followed, then any decision that requires an invocation of entire fairness also man-

75. *Id.*

76. It is interesting that the aforementioned *Speedway* case, decided in 2003, held that *Sinclair* was clearly applicable to a sale of property from a subsidiary to a parent. Although these two cases are clearly in conflict, it seems much more sensible to state that *Speedway* got it right. *See Speedway*, 2003 WL 22400758, at *2.

77. *Maxxam*, 659 A.2d at 773.

78. *Weinberger*, 457 A.2d at 703.

dates that a Cleansing Act merely shifts the burden from the defendant to the plaintiff, rather than returning the standard to business judgment. However, situations that are not as inherently ripe with conflicts as parent-subsidiary mergers should not be subject to an entire fairness analysis absent a finding of self-dealing on the part of the parent company.

The specific facts of *Maxxam* portray a board of directors captured by a parent company behaving in a manner that clearly harmed its subsidiary. The court felt that the correct standard of review was entire fairness, and because its decision relates only to the specific facts involved, it is difficult to argue that fairness was inappropriate. Finally, although the court's decision to return to the business judgment rule after a Cleansing Act is sound, the validity of this holding in light of other Delaware decisions is unclear.

II.
Does it Matter?

Having analyzed the case law, the first question to ask is whether the discrepancies in the courts' application of *Sinclair* and *Weinberger* have any practical impact. At first glance it would seem the answer is no, because courts will eventually reach the same conclusion whether they apply *Sinclair* or *Weinberger*. A few hypotheticals will help to illustrate this point.

A. *Analyzing the* Weinberger *Line Under* Sinclair

First, imagine that *Sinclair* had been applied to all of the cases discussed above which applied *Weinberger*. In *Weinberger* itself, a court applying *Sinclair* undoubtedly would have found that the Sinclair Test had been satisfied and that entire fairness was the appropriate standard of review. Signal caused UOP to enter into a transaction from which it derived a benefit. Signal would not have otherwise embarked upon the merger. Furthermore, this benefit was received to the detriment and exclusion of the minority shareholders, as they were forced into accepting a merger price which Signal knew from the Arledge and Chitea study was less than ideal. At least one commentator has speculated that the *Weinberger* court's reason for ignoring *Sinclair* was that the exclusion and detriment suf-

fered by the minority was plainly obvious.[79] The end result for *Weinberger*, and probably for all parent-subsidiary cash-out mergers, is apparently the same whether *Sinclair* or *Weinberger* is applied. An explicit analysis of *Citron* under *Sinclair* is unnecessary, as the result would be the same as that in *Weinberger*.

Although *In re Maxxam* did not involve a merger, the result under *Sinclair* is also the same as that in *Weinberger*. As mentioned above, Federated forced its subsidiary, Maxxam, not only to loan money in order to facilitate the purchase of real estate, but also to purchase that real estate at an inflated price when the investment went sour. Clearly, the parent company forced its subsidiary to engage in activity from which it benefited. Equally clear is the fact that the subsidiary was excluded from that benefit to its detriment. So even if the *Maxxam* court had applied the Sinclair Test, ultimately it would have applied entire fairness, just as it did after applying *Weinberger*.

The foregoing analysis provides a strong basis for concluding that the courts' selection of *Weinberger* instead of *Sinclair* was not outcome determinative. The next section seeks to determine if the same holds true when applying *Weinberger* to the *Sinclair* line of cases.

B. *Analyzing the* Sinclair *Cases Under* Weinberger

It is reasonable to assert that the courts in *Summa*, *MGM*, and *Sinclair* itself would have reached the same result if they had applied *Weinberger* instead of *Sinclair*. In all three decisions the courts first found that the Sinclair Test had been satisfied and then went on to apply entire fairness. There is no need to speculate here as to how the courts would have come down in applying entire fairness because they performed that analysis in their opinions. This observation raises a simple but important point: assuming that courts engage in the same fairness analysis irrespective of the *Sinclair* analysis, then any case requiring entire fairness under *Sinclair* should come out the same way under *Weinberger*. This makes sense because the concepts of benefit, exclusion, and detriment are inherent in

79. *See* Siegel, *supra* note 14, at 56 ("if the [Sinclair Test] were applied to any parent-subsidiary cash-out merger, the parent corporation would be deemed to be receiving an advantage – remaining a shareholder – to the exclusion and to the detriment of the cashed-out minority").

the entire fairness standard. Any action found to fail the Sinclair Test should fail entire fairness as well.

This leaves the *Speedway* case to analyze. Recall that in *Speedway*, the chairman, CEO and majority shareholder agreed to buy losing assets from the corporation and promised to remit to the corporation any profits he made from the resale of those assets. Under *Sinclair*, Smith, the CEO, did not receive anything to the detriment of the minority shareholders because the agreement to remit profits foreclosed that possibility.[80] This reasoning would hold up under *Weinberger* as well. Indeed, how could a transaction not be entirely fair to X if Y agrees to remit any profits made from that transaction to X? The answer is that it must be entirely fair.

Although *Speedway* would come out the same way under *Weinberger*, it raises an important concern that will be more fully developed in the next section. Assuming that proving a transaction is entirely fair is a relatively arduous process, it is probably not appropriate to submit apparently well-meaning managers like Mr. Smith to the cost and aggravation of such a process whenever any disgruntled shareholder decides to bring a suit.

C. *Outcome Determination Is Not the End of the Story*

The fact that the *Weinberger* and *Sinclair* lines of cases lead to the same outcome explains why the Delaware courts have not found it necessary to clarify the superficially conflicting doctrines in this context; as a practical matter it really does not seem to make much of a difference. Nonetheless, there are two isolated areas where the current Delaware jurisprudence could still prove problematic.

The first problem is illustrated by the *Speedway* decision. The primary danger associated with applying a *Weinberger* fairness analysis to everyday transactions is that it places a burden upon the company to defend its actions. The Erosion of the Law of Controlling Shareholders suggests that there are significant costs associated with fairness review because it takes time and money to defend against accusations of unfairness.[81] Every time a corporation has to call a lawyer, set foot in a court

80. *Speedway*, 2003 WL 22400758 at *2.
81. Siegel, *supra* note 14, at 72.

room, or even waste a manager's time thinking about these issues, it costs money. Additionally, we don't want good managers like Smith in *Speedway* to be subjected to unnecessary litigation.

Although The Erosion of the Law of Controlling Shareholders made much of this potential problem, these concerns must be taken with a grain of salt. The current body of Delaware case law does not reflect a rush of angry shareholders taking their parent companies to court for everyday business disputes. Additionally, the case law would come out the same way regardless of which standard is applied. Delaware courts seem to be reaching fair decisions. The fact that they do not articulate every step of their analysis does not mean that they are failing to consider the guidance provided by *Weinberger* and *Sinclair*. Ultimately, it is difficult to criticize a body of case law which, although applied inconsistently, does not alter the outcome for the players involved.

The second problem with the differing applications of *Weinberger* and *Sinclair* is harder to dismiss. Under *Sinclair*, if a plaintiff cannot satisfy the heightened pleading standards of the Sinclair Test the court goes back to evaluating the defendant under the business judgment rule. This makes sense as the transactions involved in *Sinclair* were not as serious, final, or ripe with conflicts as the transaction in *Weinberger*. Under the facts of *Weinberger*, even if a Cleansing Act is shown, the result is a mere shifting of the fairness burden. As mentioned in Section I, the *Weinberger* court reasoned that in the context of an end-game parent-subsidiary merger, the inherent conflicts were too great for a court to allow a return to the business judgment rule.

The Erosion of the Law of Controlling Shareholders referenced Dean Manning's approach to categorizing transactions in order to propose a sensible delineation of when to apply entire fairness. That same categorization is helpful here. Manning came up with the concepts of "enterprise" and "ownership-claim" as a way to describe transactions that come under different levels of judicial scrutiny.[82] Enterprise issues are everyday operations issues, whereas ownership-claim issues are those that directly relate to the owners' shareholding interests in the company.

82. *Id.* at 43.

It seems clear from both common sense and Delaware case law that applying entire fairness to ownership-claim controlling shareholder mergers is the correct course of action.[83] Controlling shareholder mergers are special because: (i) they represent the frozen out shareholders' last chance to receive something in exchange for their shares; (ii) they often pose a significant opportunity for quantifiable loss or gain by the minority shareholders; and (iii) they are relatively infrequent so there is less likelihood of abusive shareholder actions against honest corporations. Consequently, as the *Weinberger* court reasoned, they should always be subject to entire fairness, even if there is a Cleansing Act.

It is reasonable to assert that business people should not be subject to the heightened judicial scrutiny and costs associated with entire fairness review for all of their business activities. Perhaps entire fairness for all transactions could be justified if it were shown that parent companies consistently and routinely abused relationships with their subsidiaries to their advantage. As no authority has ever asserted that this is the case, the only sensible approach is to determine on a case by case basis if an abuse of the relationship has occurred.

However, if we accept wholesale the *Weinberger* analysis, it would mean that an enterprise transaction could never be reviewed under the business judgment rule in the parent-subsidiary context. As mentioned above, the *Weinberger* decision mandates only a shifting of the entire fairness burden, whereas *Sinclair* dictates a return to business judgment upon a failure by the plaintiff to satisfy Sinclair's pleading standards. The failure to satisfy *Sinclair*'s pleading standards is somewhat analogous to a Cleansing Act in that it provides evidence for the court that the defendant did not engage in self-dealing. Accepting this analogy, *Weinberger* and *Sinclair* diverge when it comes to determining the proper standard to apply after evidence is provided showing a lack of self-dealing. Here, the distinction *does* matter.

D. *What Should Delaware Do?*

Given the above discussion of the costs and benefits associated with the blanket entire fairness approach taken by the

83. *Id.*

court in *Weinberger*, it seems that *Weinberger* and *Sinclair* should be clarified, at least insofar as they relate to the shifting of a burden or a return to the business judgment rule. It seems sensible that outside the parent-subsidiary merger context, evidence of a lack of self-dealing should return the court to a business judgment analysis. The court could achieve this result by holding that under *Weinberger* the standard shifts back to business judgment outside of the merger context.

As mentioned above, the court seemed to implicitly adopt this reasoning in *Maxxam*, but *Maxxam*'s precedential value is limited considering the contrary holdings in Delaware on the same issue. Even if any of the cases in the *Sinclair* line is considered to be controlling, the burden-shifting problem persists because *Sinclair* is merely a pleading standard that precedes entire fairness review. Once a plaintiff satisfies the Sinclair Test the defendant is stuck in entire fairness review and under *Weinberger* even a showing of a Cleansing Act will only serve to shift the burden. Even with a shifted burden, a fairness review seems inappropriate in cases like *Speedway* and *Maxxam*.

III.
A NOTE FOR PRACTITIONERS

Having discussed what the Delaware court has done and what it could do further to clarify the case law, this section provides some practical suggestions for practitioners dealing with the current state of the law.

A. *Safe Assumptions*

The safest assumption for a practitioner to make about the current state of Delaware law in the parent-subsidiary context is that *Weinberger* applies to parent-subsidiary merger transactions. Not only is the application of entire fairness to parent-subsidiary mergers sensible, but it has been accepted by Delaware courts in subsequent case law.[84]

84. *See* Emerald Partners v. Berlin, 787 A.2d 85, 91 (Del. 2001) (citing *Weinberger* as requiring entire fairness in a case that involved a merger); Kahn v. Tremont, 694 A.2d 422, 428 (Del. 1997) (in the context of a merger, citing *Weinberger* for the proposition that entire fairness applies); Kahn v. Lynch Communication Sys. Inc., 669 A.2d 79, 82 (Del. 1995) ("normally a controlling shareholder . . . bears the burden of proving the entire fairness of a transaction in the context of a parent-subsidiary merger").

It also seems relatively safe to assume that *Sinclair* still has vitality in the context of determining the fairness of dividend distributions. *Sinclair* itself contained a relatively lengthy discussion of the circumstances under which dividends could be distributed without triggering a fairness review (they have to be distributed pro rata),[85] and *Gabelli* reaffirmed *Sinclair*'s validity with respect to dividend cases after *Weinberger*.

B. *Moderately Safe Assumptions*

It seems relatively safe after the 2003 *Speedway* holding to assume that the court will apply *Sinclair* in the case of an ordinary asset purchase by a controlling shareholder or parent. Of course, given the indeterminate state of this body of law, a different court might have applied a fairness review. However, it is also advisable to recall that at least one decision relied on *Weinberger* in the context of a parent-subsidiary loan.[86] As it is difficult to see how the loan in *Maxxam* could be distinguished from the asset purchase in *Speedway*, the analysis of a given fact pattern should be made with an eye towards both of these decisions.

Finally, practitioners should take care to remain alert to the burden-shifting issue. One can imagine a court accepting an argument that the *Maxxam* court implicitly approved a return to the business judgment rule outside the merger context upon the showing of a Cleansing Act. However, a court might also reasonably accept *Weinberger* wholesale and merely allow a shift of the fairness burden in such a case.

C. *Everyday Decisions*

This note has demonstrated that the *Weinberger* and *Sinclair* analyses generally can be expected to produce the same outcome. This does not, however, mean that the concerns related to this area of Delaware jurisprudence are purely academic. It can make a very big difference in the preparation of a client's case if the attorney knows whether to expect a simple *Sinclair* analysis or a *Weinberger* entire fairness review. However, for everyday advice to clients in a transactional context, knowing which standard will be applied probably makes little practi-

85. *Sinclair*, 280 A.2d at 723.
86. *See Maxxam*, 659 A.2d 760.

cal difference. Practitioners should always encourage their clients to treat subsidiaries in a fair and equitable manner. Analogous market transactions and other external "checks" on internal decisions should be employed as a matter of good business practice. Obviously, no lawyer should advise his or her client to cheat its subsidiaries. The differences between *Weinberger* and *Sinclair* should not matter on a daily basis as either an external advisor on a transactional basis or as in-house counsel.

IV.
CONCLUSION

This paper has demonstrated that the doctrine of parent-subsidiary fiduciary duties in Delaware is difficult to decipher but consistent in outcome. The confusion in the case law should not affect an attorney in advising his clients. However, the confusion in the law creates doctrinal dissonance that complicates matters for attorneys preparing a trial strategy and for academics analyzing the law.

The *Sinclair* standard provides a screening test for when ordinary business decisions should be subject to entire fairness. On the other hand, *Weinberger*'s entire fairness analysis is entirely appropriate for parent-subsidiary mergers because of the seriousness and finality of that type of transaction. Ultimately, the problem created by the application of these two different standards is that it is unclear whether outside the merger context Cleansing Acts will result in a shift of the burden of proving entire fairness or in a return to the business judgment rule. A clarification of the law on this issue would be useful for practitioners, corporate clients, and academics alike.