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Redefining Director Liability in Duty of Care Cases: The Delaware Supreme Court Narrows *Van Gorkom*.

*Cinerama, Inc. v. Technicolor, Inc.*¹

I. INTRODUCTION

The Delaware Supreme Court has long held that once plaintiff shareholders demonstrate that defendant corporate directors have breached any of their fiduciary duties² in approving a transaction, the business judgment rule is rebutted and the directors bear the burden of showing that the merger was entirely fair to the shareholders.³

In *Technicolor II*, the Delaware Supreme Court examined the propriety of a summary judgment order in favor of corporate directors when plaintiff shareholders were unable to demonstrate that they had suffered actual damages resulting from the directors' breach of their duty of care. The court stated that even if, at the pleadings stage of trial, it is clear that the plaintiff shareholder will not be able to demonstrate actual damages, summary judgment is not appropriate; and that corporate directors still must demonstrate entire fairness to escape liability.⁴

Although the court declared that the directors were not entitled to summary judgment in *Technicolor II*, it held in *Technicolor III* that the directors were not liable for any damages since the directors demonstrated that

1. 663 A.2d 1156 (Del. 1995). [hereinafter *Technicolor III*].

2. There are two basic fiduciary duties: the duty of loyalty and the duty of care. The duty of loyalty states that directors must give the interest of the shareholders primary consideration when deliberating on corporate policy. The duty of care requires that the directors adequately inform themselves before deciding on corporate issues. See LEWIS D. SOLOMON & ALAN R. PALMITER, CORPORATIONS §20.1 (1994).

3. *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983). The business judgment rule creates a presumption that the business decisions of corporate directors are made in compliance with their fiduciary duties and therefore not reviewable by a court. See *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984) (explaining that under Delaware law, unless the plaintiff demonstrates that the directors were 'grossly' negligent in approving a challenged transaction, the directors business decision will not be reviewed by a court); cf. *Bold v. Simpson*, 802 F.2d 314, 319-20 (8th Cir. 1984). (holding that under Missouri law, the degree of care required on the part of corporate fiduciaries is that which an ordinarily prudent person under similar circumstances would have exercised).

4. *Technicolor III*, 663 A.2d at 1162.

the merger was entirely fair to the shareholders.⁵ This Note suggests that the Delaware Supreme Court decision in *Technicolor III* will render its controversial decision in *Smith v. Van Gorkom*⁶ largely irrelevant.

II. FACTS AND HOLDING

MacAndrews Forbes Group (MAF) entered into negotiations with Technicolor Corporation to purchase Technicolor in the summer of 1982.⁷ Technicolor's chairperson, Ronald Perelman, and MAF's chairperson, Morton Kamerman, negotiated the details of the merger from September 10, 1982 until October 27, 1982.⁸

Under the agreement, MAF would first offer \$23 per share for Technicolor's stock and then initiate a second step merger in which it would convert Technicolor's remaining outstanding shares to \$23 per share in cash.⁹ Technicolor's board of directors approved the merger in a meeting on October 29, 1982.¹⁰

MAF had acquired approximately 83% of Technicolor's stock by December 3, 1982 and closed the original tender offering.¹¹ Technicolor's shareholders approved the merger agreement on January 24, 1983.¹² MAF implemented the second step merger after shareholder approval and all of Technicolor's remaining outstanding shares were converted into \$23 per share in cash.¹³

Cinerama owned 201,000 shares of Technicolor's common stock.¹⁴ Cinerama refused to tender its shares in MAF's original tender offering.¹⁵ Cinerama also dissented from the second step merger and filed a petition for an appraisal of the value of its shares pursuant to Delaware Code Annotated,

5. *Id.* at 1180.

6. 488 A.2d 858 (Del. 1985).

7. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 352 (Del. 1993) [hereinafter *Technicolor II*]. Technicolor's stock had experienced wide fluctuations in price in the late 1970s and early 1980s. Technicolor's stock traded in the \$8 to \$10 price range during the late 1970s. The stock peaked in value at \$28.50 per share in April 1981. However, when MAF began negotiations in the summer of 1982, Technicolor's shares were trading in the \$9 to \$10 price range. *Id.* at 351 n.5.

8. *Technicolor II*, 634 A.2d at 353-56.

9. *Id.* at 356.

10. *Id.*

11. *Id.* at 357.

12. *Id.* at 358.

13. *Id.*

14. *Technicolor III*, 663 A.2d 1156, 1160 (Del. 1995).

15. *Id.*

title 8, section 262.¹⁶ Cinerama uncovered evidence while conducting discovery in the appraisal proceeding that caused it to believe that Technicolor's board had breached its fiduciary duties in approving the merger with MAF.¹⁷ As a result of these findings, Cinerama filed a personal liability action against Technicolor's directors.¹⁸ Cinerama contended that the true value of its Technicolor stock at the time of the merger was \$62.75.¹⁹ Cinerama also asserted that it should be awarded rescissory damages due to the board's alleged breach of their fiduciary duties in approving the merger.²⁰

The Chancellor first appraised the value of Technicolor's common stock at \$21.60 per share, approximately \$2.00 below the merger price.²¹ The Chancellor also found that the board had breached its duty of care by failing to adequately inform themselves of the true value of Technicolor's stock.²² However, the Chancellor maintained that the board had not breached its duty of loyalty.²³ The Chancellor then declared that in cases involving duty of

16. *Id.* Under Delaware law, only a majority of shareholders of a corporation need to approve a merger with another company. *See* DEL. CODE ANN. tit. 8, § 251(b) (Michie Supp. 1994). However, a shareholder who does not vote in favor of the merger may dissent from the merger and file a petition in the Court of Chancery to have its stock appraised. DEL. CODE ANN., tit. 8, § 262(a) (Michie Supp. 1994). If the Chancellor finds that the price offered by the acquiring company was lower than the appraised value, the dissenting shareholder will receive the difference between the two values. DEL. CODE ANN., tit. 8, § 262(i) (Michie Supp. 1991).

17. *Technicolor III*, 663 A.2d at 1160. Cinerama discovered evidence that Technicolor's board may have violated its duty of care by failing to adequately inform itself of the intrinsic value of Technicolor's stock before approving the merger. *Cinerama, Inc. v. Technicolor Inc.*, Civ. A. No. 8358, 1991 WL 111134, at *2 (Del. Ch. June 24, 1991). [hereinafter *Personal Liability Action*]. Cinerama also uncovered evidence that at least some of Technicolor's board members may have had a personal interest in the success of the merger; and therefore, the board had breached its duty of loyalty. *Id.*

18. *Personal Liability Action*, Civ. A. No. 8358, 1991 WL 111134 (Del. Ch. June 24, 1991). The Chancellor first ruled that Technicolor must elect between the appraisal action or the personal liability action. *Cede & Co. v. Technicolor, Inc.*, 542 A.2d 1182, 1184 (Del. 1988) [hereinafter *Technicolor I*]. However, the Delaware Supreme Court reversed on an interlocutory appeal and held that Cinerama could proceed with both claims at the same time. *Id.* at 1192.

19. *Personal Liability Action*, Civ. A. No. 8358, 1991 WL 111134, at *2.

20. *Id.* Rescissory damages are equitable in nature and are designed to put the aggrieved party in the position it would have been in if the transaction had not occurred. *See* DAN B. DOBBS, *LAW OF REMEDIES* § 4.3(b) (2d ed. 1993).

21. *Technicolor II*, 634 A.2d at 350.

22. *Id.*

23. *Personal Liability Action*, Civ. A. No. 8358, 1991 WL 111134, at *2.

care questions, the plaintiff is only entitled to recover actual financial harm.²⁴ The Chancellor held that since it appraised the value of Technicolor's stock below the merger price, Cinerama could not prove damages and dismissed the case.²⁵

The Delaware Supreme Court reversed the Court of Chancery in *Technicolor II*. The court held that once the plaintiff demonstrates that the director defendants have breached any of their fiduciary duties, the business judgment rule is rebutted.²⁶ The burden then shifts to the defendant directors to show that the transaction was entirely fair to the shareholders in order to avoid liability.²⁷ The court then remanded the case back to the Court of Chancery to ascertain if the merger was entirely fair to Technicolor's shareholders.²⁸

The Chancellor on remand again declared that in cases involving directors' breach of their duty of care, rescissory damages are never appropriate.²⁹ Therefore, plaintiffs can only recover the difference between the fair value of the stock at the time of the merger and the merger price.³⁰ The Chancellor further held that since the merger was a product of fair dealing and since the price was fair as determined by its appraisal of the stock in the *Personal Liability Action*, the merger was entirely fair to the shareholders.³¹

Cinerama appealed this ruling to the Delaware Supreme Court.³² The court reiterated its earlier holding in *Technicolor II* and declared that the plaintiff need not show financial damages to rebut the business judgment rule.³³ The court stated that once the plaintiff has shown that the defendants breached any one of their fiduciary duties, the defendants must show that the transaction was entirely fair to avoid substantive liability.³⁴

The Supreme Court, however, did affirm the Chancellor's ruling that the merger was entirely fair to Technicolor's shareholders.³⁵ The Supreme Court held that since the Chancellor carefully considered both the procedural and

24. *Id.* at *3.

25. *Technicolor II*, 634 A.2d 345, 361 (Del. 1993).

26. *Id.*

27. *Id.*

28. *Id.* at 373.

29. *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1145 (Del. Ch. 1994).

30. *Id.* at 1150.

31. *Id.* at 1141.

32. *Technicolor III*, 663 A.2d 1156, 1161 (Del. 1995).

33. *Id.* at 1162-63.

34. *Id.*

35. *Id.* at 1177-78.

price aspects of the merger, his conclusion that the merger was fair to the shareholders must be affirmed.³⁶

III. LEGAL BACKGROUND

A. *Asserting Damages as a Pleading Requirement*

The Delaware Supreme Court addressed the issue of what damages, if any, plaintiff shareholders need to allege at the pleadings stage in *In re Tri-Star Pictures, Inc., Litigation*.³⁷ In *Tri Star*, the plaintiffs alleged that the defendant directors had breached their duty of loyalty by failing to disclose all relevant information regarding an impending merger with the parent corporation.³⁸ The Chancellor dismissed the plaintiffs' complaint for failure to state a claim.³⁹ The Chancellor held that since the plaintiffs failed to allege that they were financially damaged by the defendants' alleged nondisclosure, their complaint did not state a cause of action.⁴⁰

The Supreme Court reversed the Chancellor's dismissal of the plaintiffs' claim.⁴¹ The court stated that once the plaintiff establishes that the defendants have breached a fiduciary duty, the burden shifts to the defendant to demonstrate that the transaction was entirely fair.⁴² Also, the court stated the measure of damages under an entire fairness analysis is not limited to the difference between the actual value of the stock and the merger price.⁴³ The court further declared that if the defendants fail to establish that the merger was entirely fair, the Chancellor may fashion any relief it feels is appropriate, including, but not necessarily limited to, rescissory damages.⁴⁴ The court then held that, based on this logic, plaintiffs are not required to plead individual financial harm in a complaint seeking damages as a result of directors' self-dealing to survive a motion to dismiss or a motion for summary judgment.⁴⁵

36. *Id.* at 1179.

37. 634 A.2d 319 (Del. 1993).

38. *Id.* at 320.

39. *Id.* at 320-21.

40. *Id.*

41. *Id.* at 321.

42. *Id.* at 333.

43. *Id.*

44. *Id.*

45. *Id.* at 334. It is interesting to note, however, that the court stated in footnote 18 that the plaintiffs in *Tri-Star* would have to produce evidence with respect to the amount of actual damages they suffered if they hope to recover more than just nominal damages. *Id.* at 334 n.18.

B. Entire Fairness

The Delaware Supreme Court in *Weinberger* held that the test for entire fairness involves aspects of both fair dealing and fair price.⁴⁶ The court in *Weinberger* also stated that the analysis is not bifurcated between fair dealing and fair price, but rather the issue must be examined as a whole.⁴⁷ Factors that the Chancellor must consider in determining whether the transaction was the result of fair dealing include: (1) the timing of the transaction; (2) whether the negotiations were conducted at arm's length, (3) whether the agreement allowed the directors to seek other bidders; (4) the directors' motivation in approving the transaction; and (5) whether the shareholders were adequately informed of all material information before approving the transaction.⁴⁸

The *Weinberger* court also addressed the issue of what constitutes a "fair price". In *Weinberger*, the plaintiff asserted that the merger price was not fair since the true value of the corporation's stock was \$5 per share higher than the merger price.⁴⁹ The plaintiff supported this allegation by offering evidence of premiums paid over market price in ten other mergers of similar corporations and a valuation of the company's stock based on a discounted cash flow analysis.⁵⁰ The directors countered the plaintiff's argument by contending that the Chancellor was correct in determining that the merger price was fair by utilizing the "Delaware block" method.⁵¹

The Supreme Court declared that the "Delaware block" method was no longer to be the exclusive method in estimating the true value of a corporation's stock.⁵² The court stated that the Chancellor must consider any valuation technique or method that is generally accepted in the financial community when determining the true value of a corporation's stock.⁵³ The

46. *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983).

47. *Id.*

48. *Id.* at 711-15.

49. *Id.* at 712.

50. *Id.* A discounted cash flow analysis estimates the value of a corporation's stock by forecasting the expected future revenues of the corporations reduced to present value. For an application of this method, see *Wach v. Continental Hosts*, Civ. A. No. 7954, 1994 WL 525222, at *10 (Del. Ch. Sept. 16, 1994).

51. *Id.* Prior to *Weinberger*, the Delaware block method was the exclusive technique in estimating the true value of a corporation's stock. Under this method, the Chancellor is required to determine certain elements of the corporation's value and then assigns weights to those values. The resulting amounts are then added together to determine the value per share of the corporation's stock. See *New Castle Dept. of Finance v. Teachers Ins. & Annuity Ass'n*, 669 A.2d 100, 103 (Del. 1995).

52. *Weinberger*, 457 A.2d at 713.

53. *Id.*

court then held that the Chancellor needed to reconsider its determination that the \$21 per share merger price was fair since it only utilized the "Delaware block" method in making that determination.⁵⁴ The court also asserted, in dicta, that although shareholders' damages should normally be limited to the difference between the merger price and the fair price, if the plaintiff is able to demonstrate that the merger was a product of the directors' self-dealing or overreaching, the Chancellor may award whatever damages it believes are appropriate, including rescissory damages.⁵⁵

The Delaware Supreme Court's exacting application of the entire fairness test, prior to *Technicolor III*, is illustrated in *Mills Acquisition Company v. MacMillan*.⁵⁶ In *MacMillan*, the Delaware Supreme Court reviewed a merger for entire fairness where the Board of Directors had failed to properly exercise procedural oversight before approving a merger and allowed two self-interested directors to manipulate the approval process.⁵⁷ The court first explained that the standard of review of a board's action under the entire fairness analysis is so exacting that it is often outcome determinative.⁵⁸ The court asserted that any identifiable breach of fiduciary duty by the directors would preclude a finding that the merger was entirely fair.⁵⁹ The court then held that the defendant directors' failure to properly oversee the merger "irremediably" tainted the transaction and conclusively demonstrated that the merger was not entirely fair to the shareholders.⁶⁰

C. *Smith v. Van Gorkom*

In its landmark opinion, *Smith v. Van Gorkom*,⁶¹ the Delaware Supreme Court addressed the relationship between the business judgment rule and entire fairness analysis. In *Van Gorkom*, directors of the Trans Union Corporation approved a merger with the Marmon Group whereby Marmon would purchase Trans Union's shares for \$55 per share.⁶² Two Trans Union shareholders

54. *Id.* at 713-14.

55. *Id.* at 714. See *supra* note 20 for discussion of rescissory damages.

56. 559 A.2d 1261 (Del. 1989).

57. *Id.* at 1279-81.

58. *Id.*

59. *Id.* at 1280.

60. *Id.*

61. 488 A.2d 858 (Del. 1985). See Jay P. Moran, Comment, *Business Judgment Rule or Relic: Cede v. Technicolor and the Continuing Metamorphosis of Director Duty of Care*, 45 EMORY L. J. 339, 359-60 (1996) (asserting that until *Van Gorkom*, Delaware courts were unwilling to remove the business judgment presumption and review transactions in duty of care cases).

62. *Van Gorkom*, 488 A.2d at 870.

brought suit against Trans Union's directors, alleging that they had been grossly negligent, and thus had breached their duty of care by failing to ascertain the true value of Trans Union's stock before approving the merger.⁶³ The directors countered by arguing that their actions did not constitute gross negligence since the merger price represented a substantial premium over the current market price, \$38 per share, of the stock at the time of the merger.⁶⁴

The *Van Gorkom* court rejected the directors' assertion and held that they had breached their duty of care by failing to adequately inform themselves of the intrinsic value of the Trans Union stock before approving the merger.⁶⁵ The court declared that market price is not a surrogate of the true value of the stock; and thus, the directors must perform some other valuation calculation to fulfill their duty of care obligations owed to the shareholders.⁶⁶

The court then analyzed whether it should remand the case back to the Court of Chancery for an entire fairness review of the transaction. The court concluded that remand on this issue was not necessary since the corporate directors could not demonstrate that the transaction was entirely fair because they violated their duty to disclose all material information to the shareholders.⁶⁷

The court concluded that there were four material facts that the directors did not disclose. First, the directors failed to disclose that they had not properly informed themselves of the fair value of the stock and over relied on Trans Union chairperson's, Van Gorkom, in agreeing to the \$55 per share merger price.⁶⁸ Second, the directors failed to disclose that the negotiations were not conducted at arm's length, as evidenced by the fact that the \$55 per share merger price was derived by calculating the highest price that would allow Marmon to finance the transaction via a leveraged buyout.⁶⁹ Third, the directors failed to disclose that they had not questioned Van Gorkom enough

63. *Id.* at 871.

64. *Id.* at 875.

65. *Id.* at 874.

66. *Id.* at 875-76. This was an unequivocal rejection of the efficient market hypothesis which posits that the all relevant, public information regarding a corporation is reflected in its stock price. See Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 STAN. L. REV. 1059 (1990).

67. *Van Gorkom*, 488 A.2d at 890. Delaware has adopted a materiality test in determining what information directors must divulge to shareholders. Under this test, if the rational shareholder would deem the information material to its decision whether to approve a transaction, the directors must disclose the information. See *Rosenblat v. Getty Oil Co.*, 493 A.2d 929, 937 (Del. 1985).

68. *Van Gorkom*, 488 A.2d at 890-91.

69. *Id.* at 891-92.

to uncover that negotiations were not conducted at arm's length.⁷⁰ Finally, the board did not disclose that they failed to uncover that the corporation's chief financial officer's, Romans's, report that the \$55 per share merger price was in the fair price range of the stock was the result of Van Gorkom's instruction to Romans to justify a leveraged buyout.⁷¹

The court asserted that because the directors had breached their duty to disclose all material information to the shareholders, the directors could not demonstrate that the merger was entirely fair to the shareholders.⁷² Thus, the court remanded the case to the Court of Chancery with instructions to award damages in the amount equal to the difference between the "fair price" of the stock on the date the merger was ratified by the directors and the merger price.⁷³ The court declared that this "fair price" was to be calculated in accordance with *Weinberger*.⁷⁴

IV. INSTANT DECISION

A. Damages

The Chancery Court held that rescissory damages are never appropriate in situations where directors have only breached their duty of care; and therefore, a plaintiff must show actual financial harm to survive a directors' motion for summary judgment.⁷⁵ The Chancellor first stated that a shareholder's action to seek monetary relief for directors' breach of their duty of care is no different than any other claim of negligence.⁷⁶ Thus, any claim asserting a breach of the duty of care must be supported by an allegation of actual financial harm to survive a motion to dismiss or for summary judgment.⁷⁷

The Chancellor then analogized the fiduciary duties of trustees and corporate directors.⁷⁸ The Chancellor observed that, under the law of trusts, a trustee is never held liable for rescissory damages when he merely failed to exercise the proper care when administering the trust property.⁷⁹ The

70. *Id.* at 892.

71. *Id.*

72. *Id.* at 893.

73. *Id.*

74. *Id.* See *supra* note 53 and accompanying text for the *Weinberger* Court's analysis of fair price.

75. *Cinerama, Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1144 (Del. Ch. 1994).

76. *Id.* at 1136.

77. *Id.*

78. *Id.* at 1146.

79. *Id.*

Chancellor stated that for policy reasons, the court should give corporate directors, as compared to trustees, more of an incentive to take risks.⁸⁰ Thus, the Chancellor asserted that corporate directors could not be liable for rescissory damages when they merely breach their duty of care.⁸¹

The Delaware Supreme Court rejected the Chancellor's position in both *Technicolor II* and *Technicolor III*.⁸² The Delaware Supreme Court emphasized that the business judgment rule is both a procedural guideline for the litigants and a substantive rule of law.⁸³ The court elaborated on this edict by declaring that, as a procedural guideline, the business judgment rule places the initial burden of proof on the plaintiff to show that the directors have breached a fiduciary duty.⁸⁴

The court next noted that, once the plaintiff rebuts the business judgment rule presumption by demonstrating that the directors breached one of their fiduciary duties, the burden shifts to the directors to show that the transaction was entirely fair.⁸⁵ The court then noted that, if the Chancellor does not find the merger to be entirely fair, it may fashion any appropriate equitable or monetary relief, including rescissory damages.⁸⁶ The court declared that it is at this point in the proceedings that the Chancellor should determine what damages, if any, the plaintiff is entitled to.⁸⁷ Thus, when seeking relief from a directors' breach of any of their fiduciary duties, including the duty of care, plaintiff shareholders do not need to plead actual damages to survive a motion for dismissal or summary judgment.⁸⁸

B. Entire Fairness

The court began its entire fairness analysis with the proclamation that the function of entire fairness analysis is to determine how the board of directors discharged all of its fiduciary duties in approving the merger.⁸⁹ The Delaware Supreme Court then addressed the fair dealing prong of the entire

80. *Id.* at 1148. This results because the trustee is essentially performing a caretaker role while a corporate director is charged with the management of a corporation, which inherently involves risk taking. *See infra* text accompanying note 126.

81. *Cinerama Inc. v. Technicolor, Inc.*, 663 A.2d 1134, 1148 (Del. Ch. 1994).

82. *Technicolor III*, 663 A.2d 1156, 1162 (Del. 1995).

83. *Id.* at 1161.

84. *Id.*

85. *Id.*

86. *Id.* at 1166.

87. *Id.*

88. *Id.*

89. *Id.* at 1172.

fairness analysis.⁹⁰ The court first observed that the negotiations between Kamerman and MAF took place at arm's length, as evidenced by the fact that Kamerman was able to induce MAF to raise its offer from \$15 per share to \$23 per share.⁹¹ The court then commented that the structure of the agreement seemed to be the product of fair dealing, since it gave Technicolor the right to provide information to, and engage in, discussion with other bidders.⁹² The court next remarked that the fact that all material information was disclosed to the directors prior to their approval was additional evidence that the agreement was the result of fair dealing.⁹³

The court then examined the manner in which Technicolor's directors approved the transaction. The court emphasized that the Chancellor must identify specific deficiencies in the board's actual conduct in discharging its duties to find that the transaction was not entirely fair.⁹⁴ Therefore, the court explained that, although the directors had been grossly negligent in not conducting an adequate valuation study of the company, the degree of care which the board exercised in approving the merger remains highly relevant in an entire fairness analysis.⁹⁵ Thus, the directors' consultation of two highly regarded financial institutions and careful consideration whether to accept MAF's offer or shop the company was evidence that the merger was entirely fair to the shareholders.⁹⁶

The court next analyzed whether the directors' approval had been the result of manipulation or overreaching by a self-interested director. The court stated that there was no persuasive evidence that any of the directors were influenced by self-interest in negotiating and approving the merger.⁹⁷ The court next asserted that the evidence also indicated that only one director, Sullivan, had a material conflict, and that no director dominated the approval process.⁹⁸ The court concluded that, on these facts, the evidence supported the Court of Chancery's finding that the Technicolor's board approval was untainted by conflict.⁹⁹

The court then declared that Cinerama's assertion—that Technicolor's directors had not made full disclosure of all relevant information to the shareholders before recommending approval of the merger—was without

90. *See supra* note 46 and accompanying text.

91. *Technicolor III*, 663 A.2d at 1172.

92. *Id.* at 1173.

93. *Id.*

94. *Id.* at 1174-75.

95. *Id.* at 1175.

96. *Id.*

97. *Id.* at 1175-76.

98. *Id.*

99. *Id.*

merit.¹⁰⁰ The court stated that, although a finding that the directors made full disclosure to the shareholders is not dispositive in an entire fairness analysis, it has "persuasive substantive significance" for three reasons.¹⁰¹ First, it removes the case from the virtual per se rule of damages for breach of the fiduciary duty of disclosure.¹⁰² Second, it bears directly upon how the approval of the stockholders was obtained.¹⁰³ Third, it places the case into the category of a non-self-dealing transaction, so that price may be the preponderant consideration outweighing other features of the merger.¹⁰⁴

The court then explored the price prong of the entire fairness analysis.¹⁰⁵ The court noted that MAF paid a 109% premium over the market price of Technicolor.¹⁰⁶ The court also recognized that experts such as Goldman Sachs indicated that the merger price of \$23 per share was fair.¹⁰⁷ The court finally observed that no rival bidder came forward, even though the MAF transaction did not close for several months after it was announced.¹⁰⁸ The court held that since Cinerama did not offer any credible rebuttal evidence that the merger price was not fair, the above mentioned factors demonstrated that the price was fair.¹⁰⁹

The Supreme Court concluded by declaring that the directors need not show that their actions were perfect in establishing that the transaction was entirely fair to the shareholders.¹¹⁰ The court asserted that, although the directors inadequately informed themselves in ascertaining the true value of the corporation, the directors had met their burden of demonstrating that the merger was entirely fair.¹¹¹ Thus, the court declared that the directors were not liable for damages, actual or rescissory.¹¹²

100. *Id.*

101. *Id.*

102. *Id.*

103. *Id.*

104. *Id.*

105. *Id.*

106. *Id.* This was the fourth highest premium paid over market price in transactions involving comparably sized companies.

107. *Technicolor-III*, 663 A.2d at 1177.

108. *Id.*

109. *Id.*

110. *Id.* at 1179.

111. *Id.*

112. *Id.*

V. COMMENT

A. *Limiting the Application of Van Gorkom*

Immediately following the Delaware Supreme Court's decision in *Van Gorkom*, there was a great deal of controversy over what its impact would be on corporate law. Most commentators suggested that *Van Gorkom* would have broad and disastrous effects upon corporate law.¹¹³ However, a significant minority of commentators asserted that *Van Gorkom* did not mark a departure from existing law and its application would essentially be limited to its facts.¹¹⁴ A careful reading of *Technicolor III* suggests that the latter view has prevailed.

Technicolor II did certainly expand the potential for director liability by holding that plaintiff shareholders do not need to plead actual financial harm to rebut the business judgment rule presumption in duty of care cases.¹¹⁵ However, in *Technicolor III*, the court significantly liberalized the application of the entire fairness standard in reviewing a challenged merger as articulated by the *MacMillian* court.¹¹⁶

In *Technicolor III*, the Delaware Supreme Court transformed the entire fairness test from a test that searches for any identifiable breach of the directors' breach of their fiduciary duties¹¹⁷ to one that requires the Chancellor to identify specific board misconduct in approving the challenged transaction.¹¹⁸ Under *Technicolor III*, if the directors can demonstrate that they properly oversaw the execution and approval of the challenged transaction, it becomes the burden of the shareholders to proffer some evidence that the transaction was not entirely fair.¹¹⁹ Thus, *Technicolor III* suggests that, in duty of care cases, the entire fairness test is to be used as a subterfuge in determining whether the directors gave adequate consideration

113. See Daniel R. Fischel, *The Business Judgment Rule and the Trans Union Case*, 41 BUS. LAW. 1437, 1455 (1985).

114. See Barry F. Schwartz & James G. Wiles, *Trans Union: Neither "New" Law nor "Bad" Law*, 10 DEL. J. CORP. L. 429, 430-31 (1985).

115. This is clearly an expansion of the *Weinberger* court's assertion in dicta that in duty of care cases, shareholder damages are limited to actual financial harm. See *supra* note 55 and accompanying text. See also Moran, *supra* note 61, at 359-60 (arguing that *Technicolor II* significantly expands the potential for director liability but failing to consider the impact of the liberalized entire fairness review given in *Technicolor III*).

116. See *supra* text accompanying notes 57-60.

117. See *supra* text accompanying note 59.

118. See *supra* text accompanying note 94.

119. See *supra* text accompanying notes 98, 100, 103, and 112.

to the terms of the merger before approving it. This marks a significant liberalization of the Delaware courts' application of the entire fairness test as illustrated in *MacMillian*.

This reformulation of the entire fairness standard in *Technicolor III* suggests the *Van Gorkom* decision will have only narrow application in the future. Specifically, *Technicolor III* contemplates that in duty of care cases, directors will only be held liable for damages in cases, such as *Van Gorkom*¹²⁰ and *MacMillian*, where the directors have failed to exercise procedural oversight of the challenged transaction and allowed a self-interested director to manipulate the approval process.

B. Reducing Transaction Costs

The *Technicolor III* court's narrowing of director liability in duty of care cases will promote efficiency since it lowers the transaction costs of conducting corporate business. A judicial rule imposing director liability will be efficient if it mimics the rule the parties would have reached if they had explicitly determined the rule by contract.¹²¹ Such a rule is efficient since it eliminates the necessity for the parties to engage in costly negotiations and thus reduces the transaction costs of conducting corporate business.¹²² The *Technicolor III* rule of director liability creates such a rule by balancing the shareholders' interest in providing an incentive to the directors to undertake risky transactions with their need for protection against directors' potential abuse of corporate power.

First, the *Technicolor III* rule gives shareholders protection against possible directors' abuse in exercising their managerial responsibilities. Under *Technicolor III's* rule of director liability, shareholders will be able to collect damages, possibly even rescissory damages, from directors if the directors shirk their managerial responsibility to oversee the approval of a transaction and simply allow a self-interested director to manipulate the approval process. Thus, *Technicolor III's* rule of director liability gives directors an incentive to consider whether to approve a transaction independent from any influence of a self-interested director.¹²³

120. Although the *Van Gorkom* court held that the merger was not entirely fair since the directors failed to disclose all material information to the shareholders, that material information was related to the fact that the directors allowed Van Gorkom to manipulate the approval process. See *supra* text accompanying notes 68-71.

121. Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1444-46 (1989).

122. See *id.*

123. See *supra* text accompanying notes 94-97.

Second, the *Technicolor III* rule gives corporate directors the incentive to engage in appropriate levels of risk taking. A basic axiom of finance is that the riskier the transaction, the greater the possibility for large returns or losses.¹²⁴ Stock holders are typically risk seeking, since they can diversify away their risk of a loss by one of their holdings if their portfolio is properly diversified.¹²⁵ Directors, conversely, are typically risk averse, since a significant loss by the corporation can cause serious damage to a director's managerial reputation and thus decrease the possibilities for future employment.¹²⁶ *Technicolor III* ameliorates this divergence between shareholder interest and director interest by assuring directors that they will not be liable in approving a risky transaction that results in losses, provided they performed their managerial duties and properly oversaw the approval of the transaction.

VI. CONCLUSION

As one commentator suggested, *Van Gorkom* may have been one of the worst decisions in corporate law history.¹²⁷ However, the Delaware Supreme Court's decision in *Technicolor III* makes it clear that *Van Gorkom* will essentially be limited to its facts by converting the traditionally exacting entire fairness test into a subterfuge for determining whether the directors exercised proper oversight in approving a transaction. This reformulation of the entire fairness test closely resembles the rule of liability shareholders and directors would bargain for if they were to explicitly contract the terms of their relationship. Thus, the *Technicolor III* decision will reduce the transaction costs of conducting corporate business.

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124. See Jonathan R. Macey, *Corporate Law and Corporate Governance: A Contractual Perspective*, 18 J. CORP. L. 185, 210 (1993).

125. See *id.*

126. See *id.*

127. See Fischel, *supra* note 113, at 1455.

