Company Act is available at http://www.legis.gov.bc.ca/bills/3rd_read/gov85-3.htm.

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Case Law
Dismissal of Stockholder Derivative Action Overturned

Transfer of Shares – Take-overs and Mergers; Directors' Duties

The Delaware Supreme Court, sitting *en banc*, recently reversed a Court of Chancery opinion dismissing stockholder derivative action. It held that: 'The complaint states a claim challenging the fairness of the Bally/Hilton merger and challenging the Bally directors' approval of the merger as having lacked a rational basis,' and that the Bally directors failed to exercise their business judgment in good faith.

Factual and Procedural Background

Plaintiff, who was a stockholder of Bally Entertainment Corporation ('Bally'), filed a complaint in the Delaware Court of Chancery, alleging that the defendant directors of Bally breached their fiduciary duties by entering into a merger agreement with Hilton Hotels Corporation that was the product of unfair dealing and provided Bally's stockholders with an unfair price. The Court of Chancery ultimately dismissed all of the claims, holding that the complaint stated only a derivative claim – waste of corporate assets – and that the plaintiff, a former Bally stockholder, lost any standing to assert that claim after the merger was completed.

The complaint, which the Supreme Court pointed out was 'not a model of clarity', alleged that Arthur Goldberg, Bally's chairman and chief executive officer, controlled the merger negotiations and allegedly informed all potential acquirers that his consent would be required for any business combination with Bally and that, to obtain his consent, the acquirer would be required to pay him substantial sums of money and transfer to him valuable Bally assets. The complaint also alleged that Hilton agreed to Goldberg's demands, but that other interested acquirers, including ITT Corporation, 'might have paid a higher price for Bally . . . but were discouraged from bidding because they were unwilling to participate in illegal transactions.'

Legal Analysis

The Supreme Court began its analysis by reviewing whether the claims asserted were direct or derivative in nature. The Court concluded, based upon prior precedents such as *Kramer v Western Pacific Industries*, Del Supr, 546 A 2d 348 (1988), that the claims asserted were direct because they directly challenged the fairness of the process and the price in the Bally/Hilton merger. Specifically, the Court concluded that the complaint sufficiently alleged that:

(i) Goldberg breached his fiduciary duty of loyalty by preferring himself over Bally and its stockholders; and
(ii) The other Bally directors breached their fiduciary duties of loyalty by acquiescing in Goldberg's self-interested negotiations and by approving a merger at an unfair price.

After concluding that the complaint adequately pleaded a direct rather than a derivative claim, the Court then reviewed whether the claims as pleaded were legally cognisable. The Court of Chancery had found that the complaint failed to allege facts that would deprive Bally's directors of the protections of the business judgment rule. The Supreme Court disagreed.

The Supreme Court held that the presumptive validity of the Bally directors' business judgment to enter into the Hilton merger had been rebutted because the allegations in the complaint, if true, are 'so far beyond the bounds of reasonable business judgment that it seems essentially inexplicable on any ground other than bad faith.' The Supreme Court stated that the Court of Chancery also found the payments and asset transfers allegedly demanded by Goldberg to be potentially 'so egregious that Board approval [could not] meet the test of business judgement,' but had dismissed the claims because it mistakenly concluded that the claims were derivative and had been extinguished by the merger. The Supreme Court also noted that if, as the complaint alleges, 'Goldberg tainted the entire process of finding an interested merger partner and negotiating the transaction by demanding a bribe, then it is inexplicable that independent directors, acting in good faith, could approve the deal.'

In conclusion, the Supreme Court noted that the 'facts that are developed during the course of the litigation may cast a very different light on the merger and the Bally directors' decisions.' However, at the pleading stage, the Court was constrained to accept all of the factual allegations as true and give the plaintiff the benefit of all inferences that may be drawn from those facts.

Parnes v Bally Entertainment Corp Del. Supr., No. 85, 1998, Berger, J.

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