V. THE SEARCH FOR LEGITIMACY I: SHAREHOLDER VOTING AND SHAREHOLDER SUITS

"[The shareholder vote] is critical to the theory that legitimates the exercise of power by some (directors and officers) over vast aggregations of property that they do not own."[215]

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A central concern of Chancellor Allen is that the authority that directors exercise over the corporation's business and affairs be legitimate. Though his concern with legitimacy was implicit in the areas considered in Part IV of this article, it becomes explicit in the areas that Parts V and VI examine.

Commentators on corporate law have traditionally been concerned about questions of legitimacy.[216] Yet recent Delaware law has been criticized for granting management vast discretion over corporate affairs and for subordinating the interests of shareholders. For example, in his well-known article, "Federalism and Corporate Law: Reflections Upon Delaware," William Cary maintains that Delaware decisions "can best be reconciled on the basis of a desire to foster incorporation in Delaware" and that it would be accurate to state that "Delaware corporate decisions lean toward the status quo and adhere to minimal standards of director responsibility both to the corporation and its shareholders."[217] Though this criticism is not

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of employees, suppliers, and bondholders. *See Struggle for Board Autonomy*, *supra* note 39, at 22-24. Since Allen provides no indication that he believes the latter conception is theoretically incoherent, then he must at least be open to the possibility that directors could be charged with duties to non-equity holders, including bondholders.

More recently, Chancellor Allen has suggested that fiduciary duties may run to creditors when a corporation is "operating in the vicinity of solvency . . . ." *Credit Lyonnais Bank Nederland*, No. 12,150, 1991 Del. Ch. LEXIS 215, at *108, *reprinted in* 17 DEL. J. CORP. L. at 1099. Professor Coffee notes that it would be ironic if Chancellor Allen, who in *Katz* wrote the leading opinion upholding threats against creditors in the context of a debt exchange offer, was also the lead authority for the proposition that such threats are impermissible because they violate fiduciary duties owed to creditors. Coffee, *supra* note 5, at 22.

215. *Blasius*, 564 A.2d at 659.

216. *See, e.g.*, JAMES W. HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970, at 87 (1970) (referring to the "supervisory roles of the legendary stockholder" in establishing accountability); Nell Minow & Michael Deal, *Corporations, Shareholders, and the Environmental Agenda*, 12 CARDOZO L. REV. 1359, 1359 (1991) (citing Edward S. Mason, *Introduction* to THE CORPORATION IN MODERN SOCIETY 6 (Edward S. Mason ed., Harvard Univ. Press 1959)).

217. Cary, *supra* note 14, at 670, 672. *See also Delaware's Intermediate Standard*, *supra* note 8, at 249-51 (prior to 1985, Delaware law granted management virtual

necessarily cast in terms of legitimacy, it reflects an implicit concern that the Delaware judiciary has compromised the legitimacy of corporate law in order to maintain Delaware's status as the primary state of incorporation for large American corporations. These criticisms provide a striking background against Allen's concern with legitimacy.

One method of legitimating directorial conduct is to grant those on whose behalf the directors act, i.e., the shareholders, the means by which to hold the directors accountable.[218] This part deals with two such means: the shareholders' right to vote and their right to bring suit against the corporation and its directors.

A. The Shareholder's Right to Vote

Chancellor Allen has maintained that the legitimacy of corporate law greatly depends on shareholders retaining an effective vote.[219] Thus, while he grants directors wide discretion when their decisions relate to the corporation's property and business affairs, he vigilantly reviews decisions whose principal purpose is to affect the balance of power between shareholders and directors. A board may take actions affecting the corporation's property or business that have "collateral" or "incidental" effects on the shareholders' franchise, but it may not, in the absence of a "compelling" justification, take actions having a direct and intended effect of limiting the efficacy of the shareholders' vote.[220]

While Allen forcefully states these views about the legitimating role of shareholder voting in *Blasius Industries, Inc. v. Atlas Corp.*,[221] his subsequent applications of the test articulated in *Blasius* are far less protective of shareholder voting rights than his statements would suggest. Unlike *Blasius*, where Allen pierced through formalities in search of the underlying reality of the transaction being challenged, later cases display the formalism seen elsewhere in his work. As in

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blanket protection in adopting defensive maneuvers in response to threat of hostile takeover).

218. One of the three major factors that are identified as legitimating the corporate system is the belief that corporate managers are accountable for their performance. Eisenberg, *supra* note 79, at 1523.

219. Allen sees "the ideology of shareholder democracy" as one of the "cultural" constraints upon director conduct that supplements legal and market constraints. Allen, *supra* note 36, at 154 n.3.

220. *See Stahl I*, 579 A.2d at 1120-22.

221. 564 A.2d 651 (Del. Ch. 1988).

other areas, the turn to formalism results in an expansion of the scope of directors' authority to act and a diminution of concern for the rights of shareholders and the legitimacy of the corporate system.

1. *Blasius*

Allen states his views on corporate voting most thoroughly in *Blasius*.[222] Blasius Industries, a 9% stockholder in Atlas, had been rebuffed by Atlas's Board when it proposed that Atlas enter into either a leveraged recapitalization or sale.[223] On December 30, 1987, Blasius caused the delivery of a written consent solicitation, pursuant to section 228 of the Delaware Corporate Law,[224] expanding Atlas's Board and proposing a slate of new directors.[225] The next day, the Atlas Board expanded the board and elected two new directors.[226] Allen found that while the directors had not acted in bad faith, they had acted "in order to impede or preclude a majority of the shareholders from effectively adopting the course proposed by Blasius."[227] According to Allen:

> The real question the case presents, to my mind, is whether, in these circumstances, the board, even if it *is* acting with subjective good faith . . . may validly act for the principal purpose of preventing the shareholders from electing a majority of new directors. The question thus posed is not one of intentional wrong (or even negligence), but one of authority *as between the fiduciary and the beneficiary*

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222. *Id.* Chancellor Allen has decided election issues both in political and corporate contexts. Similar issues arise in both contexts. *See, e.g.*, Stahl v. Apple Bancorp, Inc. (*Stahl II*), [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,412, at 97,031, 97,035 (Del. Ch. Aug. 9, 1990), *reprinted in* 16 DEL. J. CORP. L. 1573, 1583 (1991) (addressing concerns in both contexts that those in control of the election mechanism should not impermissibly restrict election activities of their opponents); Davis Acquisition Inc. v. NWA Inc., [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,434, at 97,210, 97,213 (Del. Ch. Apr. 25, 1989), *reprinted in* 15 DEL. J. CORP. L. 156, 164-65 (1990) (holding that the judge's role in deciding legal claims in both political and corporate elections requires restraint).

Despite these similarities, Allen finds the differences between voting in corporate and political elections "to be far greater than the similarities." *Kass*, Nos. 8700, 8701 & 8711, mem. op. at 7, *reprinted in* 12 DEL. J. CORP. L. at 1079.

223. *Blasius*, 564 A.2d at 653-54.

224. DEL. CODE ANN. tit. 8, § 228 (1991).

225. *Blasius*, 564 A.2d at 653-54.

226. *Id.* at 655.

227. *Id.* at 656.

> (not simply legal authority, *i.e.*, as between the fiduciary and the world at large).[228]

Allen offered two reasons why the business judgment rule does not apply to board actions taken for the primary purpose of interfering with a stockholder's vote. First, he asserted that, from a "broad institutional perspective," it can be seen that "*[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.*"[229] Allen noted that many academic commentators have criticized shareholder voting as having no practical significance.[230] If true, this claim would seem to diminish the legitimating role of voting. But in a remarkably bold assertion, Allen insisted that voting retains its legitimating role even if it has only a minor role in disciplining directors:

> [w]hether the vote is seen functionally as an unimportant formalism, or as an important tool of discipline, it is clear that it is critical to the theory that legitimates the exercise of power by some (directors and officers) over vast aggregations of property that they do not own. Thus, when viewed from a broad, institutional perspective, it can be seen that matters involving the integrity of the shareholder voting process involve consideration not present in any other context in which directors exercise delegated power.[231]

Second, representing "a less generalized, doctrinal point of view," Allen again concluded that the business judgment rule does not apply to this situation.[232] His argument here was straightforward: the business judgment rule protects a board's decision with respect to the corporation's property and business; questions of voting do not go to these issues, but rather to the proper allocation of authority between the board and the shareholders. Therefore, in Allen's view, the

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228. *Id.* at 658-59.

229. *Id.* at 659 (emphasis added). *See* Sutton Holding Corp. v. Desoto, Inc., [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,012, at 90,063, 90,066 (Del. Ch. May 14, 1991) (noting that concern for legitimacy presents an "underlying reason for shareholder elections"), *reprinted in* 17 DEL. J. CORP. L. 363, 369 (1992).

230. *Blasius*, 564 A.2d at 659 n.1.

231. *Id.* at 659.

232. *Id.*

business judgment rule does not apply to decisions taken with the intended effect of impeding voting.[233]

While Allen acknowledged "the transcending significance of the franchise to the claims to legitimacy of our scheme of corporate governance,"[234] he rejected the theory that actions taken for the principal purpose of impeding the effective exercise of the shareholder vote are per se invalid.[235] Instead, he stated that when a board takes such actions, it bears "the heavy burden of demonstrating a compelling justification."[236] In *Blasius*, the Atlas Board showed no such justification for expanding the board and electing two new directors; its actions were therefore invalid.[237]

2. Eviscerating *Blasius*

Despite Allen's bold claims about the legitimating role of shareholder voting in *Blasius*, he has failed in subsequent cases to carry through on the promise that board action affecting shareholder voting would be strictly scrutinized. Rather, he has held that only a narrow category of actions trigger the rigorous "compelling justification" standard.[238] Such actions generally include only those that impinge

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233. As stated by Allen:

> A board's decision to act to prevent the shareholders from creating a majority of new board positions and filling them does not involve the exercise of *the corporation's power* over its property, or with respect to *its* rights or obligations; rather, it involves allocation, between shareholders as a class and the board, of effective power with respect to governance of the corporation.

Id. at 660.

234. *Id.* at 662.

235. *Id.*

236. *Id.* at 661.

237. *Id.* at 663.

238. While *Blasius* has been acclaimed for clarifying the doctrine that actions with a primary purpose of interfering with the effective exercise of shareholder rights require a "compelling justification," Gregory S. Schaer, Comment, Blasius Industries, Inc. v. Atlas Corp.: *Closer Scrutiny of Board Decisions Under the "Compelling Justification" Standard*, 16 DEL. J. CORP. L. 639 (1991), most subsequent litigation has focused on which actions actually trigger that standard.

Allen drew a distinction between actions whose principal purpose is to interfere with the exercise of the shareholder vote and actions that have such an effect; only the former require a compelling justification. He emphasized the role of this distinction in *Blasius*. His conclusion that "the board was principally motivated to prevent or delay the shareholders from possibly placing a majority of new members on the board [was] critical" to his analysis of the actions' validity. *Blasius*, 564

upon a shareholder's statutory rights (e.g., to conduct a consent solicitation pursuant to section 228) or that conflict with obligations that a corporation's bylaws impose (e.g., to hold an annual meeting in a particular month every year).[239] Allen has also upheld the use of "poison pill" plans that restrict shareholders' ability most effectively to wage proxy contests.

Blasius' compelling justification requirement comes into play only when "triggered" by board actions that have a principal purpose of impeding the effective exercise of the shareholder vote. Given *Blasius*' rousing proclamations about the legitimating role of shareholder voting, there was little reason to think that only a very limited set of board actions would pull the trigger. Yet in two important

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A.2d at 655.

He went on to state that "[i]f the board in fact was not so motivated, but rather had taken action completely independently of the consent solicitation, *which merely had an incidental impact* upon the possible effectuation of any action authorized by the shareholders, it is very unlikely that such action would be subject to judicial nullification." *Id.* (emphasis added).

A distinction like this is necessary, because virtually every significant board action has some effect on shareholder voting. For example, the decision by the board of a combined oil and steel corporation to spin off the operations into two separate corporations effectively limits the ability of shareholders who oppose such a bifurcation from voting for directors who agree with them. Yet such a decision does not, therefore, require a justification beyond that required by the business judgment rule.

239. *See, e.g.*, *Blasius*, 564 A.2d at 654, 661-63 (requiring a "compelling justification" for interference with shareholders' exercise of rights under § 228); Lennane v. Ask Computer Sys., Inc., [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,674, at 98,149, 98,153-55 (Del. Ch. Oct. 11, 1990) (reconsidered Oct. 19, 1990), *reprinted in* 16 DEL. J. CORP. L. 1521, 1534-38 (1991) (holding that a compelling justification was not required where only NASDAQ rule provided for shareholder vote); Walsh v. Search Exploration, Inc., No. 11,673, mem. op. at 4-8 (Del. Ch. Aug. 31, 1990) (Allen, C.), *reprinted in* 16 DEL. J. CORP. L. 1640, 1644-47 (1991) (stating that a ruling on plaintiffs' request that an annual meeting be held promptly requires finding, as a preliminary matter, that § 211 imposes an obligation on the board to call an annual meeting); UIS, Inc. v. Walbro Corp., No. 9323, slip op. at 6 (Del. Ch. Oct. 6, 1987) (Allen, C.), *reprinted in* 13 DEL. J. CORP. L. 806, 810 (1988) (refusing to issue temporary restraining order against voting of newly-created preferred stock on grounds that such voting would interfere with the effective exercise of shareholder rights where no shareholder meeting was currently scheduled or required and "there [was] no record basis to believe that action under Section 228 [was] contemplated"); Phillips v. Insituform of N. Am., Inc., No. 9173, slip op. at 25 (Del. Ch. Aug. 27, 1987) (Allen, C.), *reprinted in* 13 DEL. J. CORP. L. 774, 789 (1988) (holding that rigorous standard of justification applies where board has failed "to hold the annual meeting at the time provided in the by-laws or to hold it within the time required by Section 211 of the corporation law").

subsequent cases, *Stahl v. Apple Bancorp, Inc. (Stahl I)*[240] and *Paramount Communications, Inc. v. Time Inc.*,[241] Allen has severely limited the circumstances in which the compelling justification standard is applicable.

In *Stahl I*, a 30% shareholder in Apple Bancorp, Inc. (Bancorp) had announced his intention to conduct a proxy contest for the election of directors.[242] On March 19, 1990, the Bancorp Board fixed April 17, 1990 as the record date; the latest date at which an annual meeting could be held with a record date of June 16, 1990.[243] The shareholder, Stanley Stahl (Stahl), commenced a tender offer March 28, 1990, to purchase any and all outstanding shares of Bancorp's common stock at $38 cash per share.[244] On April 10, Bancorp's Board deferred the company's annual meeting, which it had intended to hold in mid-May, and announced it would explore the advisability of pursuing an extraordinary transaction.[245] Stahl filed an action two days later, seeking an order requiring Bancorp to convene its annual meeting on or before June 16, 1990.[246]

Allen did not dispute that Bancorp's Board had altered its plans in response to the risk that the proposed proxy contest and tender offer would result in a change in board control and the sale of the company. He did, however, reject Stahl's claim that the deferral of the annual meeting impaired or impeded the effective exercise of the corporate franchise, *given that neither the corporation's bylaws nor section 211 required the board to call an annual meeting prior to September 1990.*[247]

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240. 579 A.2d 1115 (Del. Ch. 1990).

241. [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,264 (Del. Ch. July 14, 1989) (revised July 17, 1989), *reprinted in* 15 DEL. J. CORP. L. 700 (1990).

242. *Stahl I*, 579 A.2d at 1117.

243. *Id.* at 1119. The June 16 deadline for holding the meeting was required by § 213 of the Delaware General Corporation Law. DEL. CODE ANN. tit. 8, § 213 (1991).

244. *Stahl I*, 579 A.2d at 1119.

245. In order to defer the meeting, the Bancorp Board withdrew the April 17 record date, thus allowing itself more time to pursue alternatives to Stahl's offer. *Id.*

246. *Id.* at 1117.

247. Allen repeatedly emphasized that Stahl's action was not brought under § 211; even if the meeting were deferred, it would still "go forward at a time consistent with the company's bylaws and with Section 211 of our corporation law." *Id.* at 1123. In the absence of a "legal right to compel the holding of the company's annual meeting under Section 211(c) of the Delaware General Corporation Law" or of "a right in equity to require the board to call a meeting [at that time]," Stahl's claim was deemed without merit. *Id.*

By this *ipse dixit*, Allen immeasurably increased the burden of a plaintiff seeking to invoke the *Blasius* test, while correspondingly expanding a board's authority to take actions that may effect shareholder voting. While he appeared sensitive to the charge that his view was unduly formalistic, he insisted only that the act of actually fixing a date for an annual meeting is one of "some dignity and significance."[248] He offered no further explanation for why the board's actions had not triggered the *Blasius* standard.

Allen adopted a similarly formalistic position in *Time*.[249] The Time/Warner merger, as initially formulated, required a shareholder vote. As "retrofitted" after Paramount's intervention, the merger did not require shareholder approval. In attacking the merger, Paramount (like Stahl) invoked the authority of *Blasius*.[250] Chancellor Allen ruled that the cases were not relevantly similar. In *Blasius*, the action objected to involved statutory rights under section 228; a shareholder vote on the initial Time/Warner merger was required only by the rules of the New York Stock Exchange.[251] Hence Time and Warner could "retool" their merger so as not to require a shareholder vote without impairing or impeding the effective exercise of the shareholder franchise. This argument is, of course, no better than the argument Allen offered in *Stahl I*; indeed, it is the same *ipse dixit*.

The plaintiffs' attempts in *Stahl I* and *Time* to invoke the authority of *Blasius* are not surprising. That opinion's emphasis on the legitimating role of the shareholder franchise and on "the transcending significance of the franchise"[252] seemed to imply that board actions could impair or impede the effective exercise of the shareholder vote, even if the vote was not one to which the statute entitled the shareholder or that the corporation's bylaws obligated it to provide. However, the question arises: Why does Allen foreclose this possibility?

One possible answer connects with Allen's insistence that corporate law provide a certain level of certainty. The Delaware cor-

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248. *Id.*

249. Paramount Communications, Inc. v. Time Inc., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,264 (Del. Ch. July 14, 1989) (Revised July 17, 1989), *reprinted in* 15 DEL. J. CORP. L. 700 (1990).

250. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988).

251. *Time*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,281 & n.18, *reprinted in* 15 DEL. J. CORP. L. at 743 & n.18.

252. *Blasius*, 564 A.2d at 662.

poration law carefully identifies the circumstances in which a shareholder vote is required. Given the care with which the Delaware General Corporation Law has been drafted, Allen may believe that a corporation should be able to rely on its provisions in determining whether a particular transaction requires a shareholder vote.

Allen may thus view a certain formalism as necessary in these circumstances. If shareholders could require a board to produce a compelling justification for actions that interfere with the exercise of some voting right, even if that right was not grounded in statute or the corporation's bylaws, then a board's ability to act might be unduly restricted because of the uncertainty as to which actions would trigger this more rigorous standard. Indeed, Warner's counsel in *Time* argued that requiring a shareholder vote, where neither the corporation law nor the corporation's bylaws required it, would lead the court down a "very, very, very slippery slope" and would inject "massive uncertainty into the corporate law as to the circumstances upon which a corporation is entitled to act."[253] Allen may believe that both rights—the board's right to make business decisions and the shareholders' right to vote—are better protected when only those acts that impinge on statutory rights or corporate bylaws trigger the need for a compelling justification.

However, Allen could have found that the *Blasius* standard was triggered in both *Stahl I* and *Time* without any significant loss in terms of certainty. In *Stahl I*, the board itself had already set the record date, and that date determined the latest date at which it could set the annual meeting. Only by according an almost ritualistic significance to the *actual* setting of the date of the annual meeting, an issue that in view of the setting of the record date was only minimally related to questions of certainty, could Allen maintain that the board's action did not trigger the *Blasius* standard. Similarly in *Time*, finding that board actions have the principal effect of impeding the effective exercise of rights conferred by *the rules of the New York Stock Exchange* triggered the *Blasius* standard would hardly seem to inject "massive uncertainty" into the corporate law. Therefore, it

253. Argument on Plaintiffs' Motion for Preliminary Injunction at 168, 169, Paramount Communications, Inc. v. Time Inc., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,264 (Del. Ch. July 14, 1989) (transcript of hearing on July 11, 1989) (remarks of Herbert M. Wachtell). *See also id.* at 175 (requiring shareholder vote in these circumstances would cast the corporation law "adrift from the certainty of our statute") (remarks of Charles F. Richards, Jr.).

is apparent that a concern about certainty is not the key explanatory factor in these decisions.

A second possibility, which a recent commentator has labeled "speculative," is that the departures from *Blasius* are to be explained by the dynamics of the relationship between the Delaware Supreme Court and the chancery court, particularly Chancellor Allen.[254] According to this suggestion, Allen's opinions were "affected" by the supreme court's opinion in *Time*, which "strengthened the hand of incumbent boards to resist hostile tender offers" and "disfavored the reasoning of certain pro-shareholder opinions which the chancellor had written."[255] The principal result, and perhaps the main point, of explanations such as this is to portray Chancellor Allen as a jurist bent on radical alterations of Delaware corporate law who has been curbed and restrained by a conservative and benighted supreme court. Before we accept such explanations, however, one must inquire more into just how decisions such as *Time* might have "affected" Chancellor Allen in his post-*Blasius* decisions. There was, after all, no explicit reference to the *Blasius* line of cases in *Time*. Had Chancellor Allen wanted to carry through on the apparent promise of *Blasius*, it is unclear how anything the supreme court did subsequent to that case, or in *Time*, would have constituted a compelling reason for his not doing so.

A final possible explanation for Allen's apparent change of view is that, in the period between 1988 and 1990, Allen came to view shareholder voting with more skepticism. In a lecture given in October 1990, he stated: "For the moment . . . in practically all situations involving public companies the shareholder vote supplies a tenable but not compelling basis for legitimation and, no accountability."[256] This language is a departure from Allen's language in *Blasius*, which insisted on the legitimating role of shareholder voting even if it had no practical effect in disciplining management. He seems to have retreated from *Blasius*' ringing endorsement of the legitimating role of shareholder voting; he instead seems to be in the process of formulating a position that more fully takes into account the constraints on the ability of shareholders, especially "non-ag-

254. Robert J. Klein, Note, *The Case for Heightened Scrutiny in Defense of the Shareholders' Franchise Right*, 44 STAN. L. REV. 129, 170 (1991).

255. *Id.*

256. *Competing Conceptions*, *supra* note 13, at 25.

gregated" shareholders,[257] significantly to control managerial decision making.

Chancellor Allen has also retreated from his *Blasius* position by upholding poison pill rights plans that have significant effects on shareholder voting. The Delaware Supreme Court, in *Moran v. Household International, Inc.*,[258] addressed the implications of a poison pill on a potential acquiror's ability to conduct a proxy contest. Plaintiffs, who sought invalidation of the target's poison pill, argued that the target's board was unauthorized to enact a poison pill that fundamentally restricted stockholders' rights to conduct a proxy contest.[259] The court upheld the board's authority to enact the defense mechanism, finding that its effects on proxy contests would be minimal.[260] The court noted, however, that holders of revocable proxies were exempted from the rights plan's "beneficial ownership" provisions; therefore, merely having the right to vote a certain percentage of stock would not in itself trigger the poison pill.[261]

The effects of poison pills on a potential acquiror's ability to conduct a proxy contest have recently received considerable attention due to the increase in proxy fights.[262] Chancellor Allen's later decision in *Stahl v. Apple Bancorp, Inc. (Stahl II)*,[263] the most important recent decision on the issue, raises questions about his views on the role of shareholder voting similar to those just considered.

Having been defeated in his attempt to compel the Apple Bancorp Board to hold an annual meeting by mid-June, Stanley Stahl was next concerned that his ability to conduct a proxy contest would be unduly restricted by the "beneficial ownership" provision of Apple Bancorp's poison pill plan.[264] Stahl contended that the board lacked

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257. Chancellor Allen has suggested that the increasing influence of institutional shareholders indicates that "we may be on the cusp of a new era [signifying] the age of the re-aggregated shareholder." *Struggle for Board Autonomy*, *supra* note 39, at 26-27.

258. 500 A.2d 1346 (Del. 1985).

259. *Id.* at 1355.

260. *Id.*

261. *Id.*

262. *See, e.g.*, Gandolfo V. DiBlasi & Norman Feit, *Poison Pills Get New Attention*, NAT'L L.J., Nov. 5, 1990, at 16.

263. [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,412, at 97,031 (Del. Ch. Aug. 9, 1990), *reprinted in* 16 DEL. J. CORP. L. 1573 (1991).

264. *Id.* at 97,032, *reprinted in* 16 DEL. J. CORP. L. at 1577. A "beneficial ownership" provision defines the circumstances in which a party will be deemed to beneficially own shares of the corporation. A poison pill is "triggered" when a stockholder's beneficial ownership of shares exceeds a specified threshold. Thus, a

the authority to include a beneficial ownership provision that embraced agreements broadly related to the shareholder vote, such as agreements to serve on the same slate of directors in opposition to management, to indemnify (or be indemnified by) other shareholders in connection with running for office, or to ask for and receive permission to use the name of another stockholder for purposes of endorsing his slate.[265]

Chancellor Allen rejected Stahl's claim. He found the "thrust" of *Moran* to be whether "the restrictions imposed by the stock rights plan on a proxy contest were [material] to conducting a proxy fight effectively."[266] A restriction on revocable proxies, which are "the essence of a proxy contest," could never be immaterial.[267] Such a restriction "would be fatal to a proxy contestant's position."[268] However, Allen stated that restrictions on the type of voting agreements for which Stahl argued "plainly could be (and in this instance probably are) immaterial in the sense that a shareholder may put forth a slate of candidates and communicate her position to others, and others may vote for that slate without restriction."[269] Allen thus concluded that "[i]n light of *Moran*, I am unable to say that stockholders have an absolute right to reach agreements with each other concerning the voting of stock (excepting agreements reflected in the granting of a revocable proxy)."[270]

Allen's holding in the case was not required by *Moran*, nor is it easily reconcilable with the emphasis he has placed on the legitimating role of the corporate franchise. His use of the assertion that receipt of revocable proxies is "the essence" of a proxy contest as a basis for denying Stahl's claim is reminiscent of his assertion that, because NOBO lists play "no central role" in a proxy contest, shareholders are not entitled to them where management neither has nor intends to obtain such a list.[271] In both cases, Allen relied on highly formal distinctions to limit shareholder rights and to expand

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beneficial ownership provision that embraces a large set of circumstances makes it more likely that the poison pill will be triggered.

265. *Id.* at 97,033, *reprinted in* 16 DEL. J. CORP. L. at 1579.

266. *Id.* at 97,036, *reprinted in* 16 DEL. J. CORP. L. at 1585.

267. *Id.*

268. *Id.*

269. *Id.*

270. *Id.*

271. *See supra* notes 155-70 and accompanying text (discussing RB Assocs. of N.J. v. Gilletti Co., No. 9711, 1988 Del. Ch. LEXIS 40 (Del. Ch. Mar. 22, 1988), *reprinted in* 13 DEL. J. CORP. L. 1220 (1988)).

the authority of the board. In the situation of *Stahl II*, even if the receipt of revocable proxies is "the essence" of a proxy contest, why should only effects on this so-called essence of a contestant's ability to conduct a proxy contest be deemed material? The restrictions that Bancorp's beneficial ownership provision imposed on Stahl's ability to conduct a proxy contest were significant. This is true when the restrictions are considered singly, and even more so when considered cumulatively. Given Allen's earlier emphasis on the role of the corporate franchise, and the absence of considerations relating to the need for certainty in corporate affairs, he could have found that these restrictions constituted a material impairment of Stahl's ability to conduct a proxy contest. His growing skepticism over the legitimating role of shareholder voting may, however, have led him to be more tolerant of restrictions on a shareholder's ability to conduct a proxy contest.

B. The Shareholder's Right to Sue

Shareholder class actions and derivative actions are considered an important means for ensuring managerial accountability.[272] Rule 23(e) of the Delaware Court of Chancery requires that the court approve the settlement of such actions as fair, adequate, and reasonable.[273] However, critics have claimed that courts act "more or less as rubber stamps" in reviewing settlements and that judicial approval "appears to be highly imperfect as a protection for the plaintiffs' interests . . . ."[274]

Chancellor Allen, though, endorses shareholder litigation as a means of keeping corporate managers accountable and believes that such litigation has a role in legitimating the exercise of managerial authority.[275] In order to preserve the legitimating role of shareholder

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272. *See* ROBERT CHARLES CLARK, CORPORATE LAW 639 (1986) (stating that shareholders' derivative suits are an interesting and ingenious accountability mechanism for large formal organizations).

273. DEL. CH. CT. R. 23(e).

274. Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 48, 45 (1991). *See* Anthony Borden, *The Shareholder Suit Charade*, AM. LAW., at 67 (Dec. 1989).

275. *See, e.g.*, *In re* Anderson Clayton Shareholders Litig., No. 8387, 1988 Del. Ch. LEXIS 127, at *14 (Del. Ch. Sept. 19, 1988) ("I am mindful of *the significant institutional role of class and derivative actions* in the enforcement of the fiduciary duties assumed by corporate officers and directors.") (emphasis added); Sun Equities

litigation, he has given substance to the requirement that settlement of class action and derivative litigation be subjected to judicial scrutiny.

1. The Judicial Approval of Settlement of Shareholder Litigation

Chancellor Allen's opinion in *Stepak v. Tracinda Corp.*[276] is his most striking attempt to give substance to the requirements of Rule 23(e).[277] In 1986, Kerkorian, a principal defendant, asserted a defense of lack of personal jurisdiction in the "*Rudd*" action brought in Delaware.[278] This action was subsequently refiled as the "*Abzug*" action in California, and the plaintiffs in that case moved for class certification in December 1987.[279] Stepak filed an action in Delaware (the *Stepak* action) in April of 1986, but the complaint was not served for two years.[280] Indeed, *Stepak* was dormant until 1988, when *Abzug* began to acquire momentum.[281] Kerkorian did not raise any issue of personal jurisdiction in the revived *Stepak* action and plaintiffs moved for class certification before conducting any discovery.[282] Settlement negotiations commenced promptly after class certification

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Corp. v. Computer Memories Inc., No. 9353, 1988 Del. Ch. LEXIS 24, at *3 (Del. Ch. Feb. 16, 1988) ("The law does recognize that [shareholder actions] are an important part of the overall mechanism of corporate governance.").

In a recent lecture, Allen lamented that:

> the age of takeover litigation threatens to make a scandal of stockholder class action suits. Suits are frequently filed immediately upon a public announcement of an intention to do a deal, in many cases before a merger agreement had been reached, and settled rather promptly thereafter with small or no substantial consideration except an attorney's fee.

William T. Allen, *Private Lawyers and Civic Duties*, Address at the Investiture of Dean John A. Maher, Dickinson Law School, at 10 (Oct. 12, 1990).

276. No. 8457, 1989 Del. Ch. LEXIS 95 (Del. Ch. Aug. 18, 1989), *reprinted in* 15 DEL. J. CORP. L. 750 (1990).

277. *See also In re* First Boston, Inc. Shareholders Litig., [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,322, at 96,536, 96,542 (Del. Ch. June 7, 1990) (declining, on the grounds that he lacked sufficient information, to approve proposed settlement of shareholder class action); *In re* Republic Am. Corp. Litig., No. 10,112 (Consolidated), 1989 Del. Ch. LEXIS 31 (Del. Ch. Apr. 4, 1989), *reprinted in* 15 DEL. J. CORP. L. 214 (1990) (same).

278. *Stepak*, No. 8457, 1989 Del. Ch. LEXIS 95, at *10-11, *reprinted in* 15 DEL. J. CORP. L. at 758.

279. *Id.* at *11, *reprinted in* 15 DEL. J. CORP. L. at 758. The class was eventually certified on February 10, 1989. *Id.*

280. *Id.*

281. *Id.* at *11-12, *reprinted in* 15 DEL. J. CORP. L. at 758.

282. *Id.*

was granted and agreement on a proposed settlement was soon reached.[283]

Under the terms of the proposed settlement, plaintiffs, who included:

> —pension funds, banks, trusts, mutual funds, IRA's and mom & pop—will each have their choice among: *Poltergeist III*, *Spaceballs*, *Moonstruck*, *Betrayed* or *Child's Play*. The initial distribution is to be one per shareholder regardless of the number of shares held. Were this proposed settlement otherwise worthy of serious consideration, this condition would itself be sufficient to cause a supervising court to question the proposal.[284]

Allen valued this consideration at approximately $.05 per share.[285] Finding this amount clearly inadequate, and stating that there was "no reasonable likelihood that the proposed settlement would be approved as fair and reasonable,"[286] Allen declined even to schedule a hearing.

The opinion reflects a deep concern that the legitimacy shareholder litigation confers on the exercise of managerial power not be compromised by judicial endorsement of settlements that are not fair, adequate, or reasonable. Allen found the proposed settlement "subversive of the policy sought to be served by Rule 23 and deeply offensive to the spirit of that rule."[287] Indeed, candor compelled him to say that

> the proposed settlement, alone among the many such applications I have been required to review, engenders disdain that is pronounced and lingers. It is frankly unimaginable that I could exercise my judgment to approve it as fair to the class. Moreover, *approval of such a proposal would, in my opinion, threaten to hold the class action mechanism up to justifiable scorn and to charges, too frequently made without adequate grounds, that the stockholder class action mechanism represent [sic] nothing so much as a device for lawyers to enrich themselves while serving no practical interest of those for whom they are charged to act.*[288]

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283. *Id.* at *12, *reprinted in* 15 DEL. J. CORP. L. at 759.
284. *Id.* at *13 n.3, *reprinted in* 15 DEL. J. CORP. L. at 759 n.3.
285. *Id.* at *14, *reprinted in* 15 DEL. J. CORP. L. at 759.
286. *Id.* at *4, *reprinted in* 15 DEL. J. CORP. L. at 755.
287. *Id.*
288. *Id.* at *19, *reprinted in* 15 DEL. J. CORP. L. at 762 (emphasis added).

2. The Award of Attorney's Fees

Chancellor Allen has also attempted to preserve the legitimating role of shareholder litigation by raising the standard that plaintiffs' attorneys must meet to receive attorney's fees. Delaware has a three pronged test to determine whether counsel in a derivative or class action that has not gone to judgment is entitled to fees: (1) the suit must have been meritorious when filed, (2) action producing benefit to the shareholders or the corporation must have been taken by the defendants prior to judicial resolution, and (3) the resulting benefit must be causally related to the lawsuit.[289] Delaware presumes a causal connection between shareholder plaintiffs' attorneys' efforts and the achievement of benefits for the plaintiffs.[290] However, the presumption is not conclusive, and "the defendant may attempt to come forward and meet the burden and negate a presumption of relationship between the suit and the benefit."[291]

The recent surge of takeover activity focused attention on the relationship between the benefit and the suit, for in takeover litigation the crucial question often concerns "the role of the litigation itself in producing the benefit, as contrasted with the role of other agencies."[292] The problem in such cases is that shareholder litigation is initiated immediately upon the announcement of an intention to propose a change in control or some other extraordinary corporate transaction. Yet it is quite unlikely that the deal as initially proposed will be the precise deal effectuated.[293] Moreover, tender offerors usually initiate litigation against the target, with the shareholder litigation effectively "piggybacking" on the work done by the offeror's counsel.

Though the causal relationship problem is especially acute in the context of takeover litigation, Allen has generally adopted a skeptical position toward the claim that shareholder litigation was causally related to the benefit produced. In order to deter frivolous or premature litigation, he subjects the claim that the shareholder

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289. *In re* Beatrice Cos. Litig., No. 8248, mem. op. at 16-17 (Del. Ch. Apr. 16, 1986) (Allen, C.), *reprinted in* 12 DEL. J. CORP. L. 199, 210-11 (1987) (citing Allied Artists Pictures Corp. v. Baron, 413 A.2d 876 (Del. 1980)).

290. *Id.*, mem. op. at 18, *reprinted in* 12 DEL. J. CORP. L. at 211; *Sun Equities*, No. 9353, 1988 Del. Ch. LEXIS 24, at *3-4 (citation omitted).

291. *Sun Equities*, No. 9353, 1988 Del. Ch. LEXIS 24, at *3-4.

292. *In re Anderson Clayton Shareholders Litig.*, No. 8387, 1988 Del. Ch. LEXIS 127, at *3.

293. *Id.* at *5.

litigation was causally related to the benefits achieved to severe scrutiny.

The most striking example of Allen's development of the causation requirement is *Sun Equities Corp. v. Computer Memories Inc.*,[294] a case in which he denied any award of attorney's fees. The suit arose out of a proxy solicitation by management of Computer Memories, Inc. (CMI) seeking shareholder approval of a complex reorganization; the proxy materials were distributed on September 24, 1987.[295] On October 9, certain litigation events occurred that substantially reduced the value of the company that was to be acquired in the transaction; CMI's Board was actively considering what course to follow in light of this development.[296] On October 19, Sun Equities, a substantial CMI shareholder, filed suit challenging the adequacy of the proxy statement.[297] Shortly thereafter CMI's Board exercised its right to abandon the transaction, thereby rendering CMI's action moot.[298] Plaintiff then moved for an award of counsel fees.

Chancellor Allen found that defendants had sustained their burden in rebutting the presumption that the litigation was causally related to the benefit produced by establishing that the abandonment of the transaction was in no respect causally related to the filing of the lawsuit.[299] He concluded that "plaintiff acted prematurely in this instance and that the abandonment of the deal was an event that would have occurred—the process that led to it being underway both before and after he acted unilaterally—without any aid or stimulus from the filing of a complaint in [chancery] [c]ourt . . . ."[300]

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294. No. 9353, 1988 Del. Ch. LEXIS 24 (Del. Ch. Feb. 16, 1988).
295. *Id.* at *1.
296. *Id.* at *1-2.
297. *Id.* at *2.
298. *Id.*
299. *Id.* at *11.
300. *Id.* at *6-7. Even when Chancellor Allen has found a causal connection sufficient to justify an award of attorney's fees, he has taken the degree of causal connection into account in determining the amount of fees. This latter inquiry has frequently resulted in a substantially reduced award, a result that comports with Allen's desire that the role of shareholder litigation not be compromised by the filing of premature and frivolous suits. *See, e.g.*, *In re* Maxxam Group, Inc. Stockholders Litig., No. 8636 (Consolidated), mem. op. at 30-34 (Del. Ch. Apr. 16, 1987) (Allen, C.), *reprinted in* 13 DEL. J. CORP. L. 324, 345-47 (1988) (awarding attorneys' fees of less than half the amount requested in light of the "indirect" and "limited" causal relationship between the litigation and the benefit); *In re Anderson Clayton Shareholders Litig.*, No. 8387, 1988 Del. Ch. LEXIS 127, at *11 (finding causal connection sufficient to justify award of some attorney's fees, though

Even when Allen has found an award of attorney's fees appropriate, and has not granted an award lower than that requested, he has ruled in a creative manner designed to deter the filing of premature and frivolous litigation. *In re Amsted Industries Inc. Litigation*[301] involved several shareholder class action lawsuits challenging a management sponsored leveraged buyout of Amsted Industries Inc. The day after an initial, $48 per share offer, the first shareholder class action suit was filed; shortly thereafter, three more suits were filed.[302] Subsequent events resulted in a reduction of the offering price, and a transaction was ultimately proposed at $47 per share.[303] After the initial step of the proposed transaction (an exchange offer) closed, Barkan, who had not previously filed suit, commenced an action attacking the exchange offer.[304] Barkan's counsel participated in the discovery that followed and initiated discovery on his own.[305]

As part of the settlement that was eventually agreed on, but to which Barkan continued to object, Amsted agreed to pay legal fees not to exceed $300,000.[306] Allen approved payment of this amount, subject to the condition that $75,000 be awarded to Barkan.[307] The award of fees to an objector constituted a departure from "the understandable mores of the subculture," which exclude from participation in the agreed upon legal fee anyone who "neglected to file suit prematurely [i.e., at the announcement of the initial transaction, which was subsequently abandoned] as had the other plaintiffs."[308] Allen nevertheless found that, despite Barkan's coun-

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connection was too "attenuated" to warrant award of attorney's fees based on the value of benefits obtained in ultimate transaction; thus awarded fees of $900,000 rather than requested $4 million). *But see In re Beatrice Cos. Litig.*, No. 8248, memo. op. at 15-21, *reprinted in* 12 DEL. J. CORP. L. at 210-13 (awarding full amount of requested attorney's fees in circumstances where litigation had limited, though "significant," causal role).

301. No. 8224, 1988 Del. Ch. LEXIS 116 (Del. Ch. Aug. 24, 1988), *reprinted in* 14 DEL. J. CORP. L. 611 (1989), *aff'd*, 567 A.2d 1279 (Del. 1989).

302. *Id.* at *10-11, *reprinted in* 14 DEL. J. CORP. L. at 617-18.

303. *Id.* at *10-17, *reprinted in* 14 DEL. J. CORP. L. at 618-20.

304. *Id.* at *17, *reprinted in* 14 DEL. J. CORP. L. at 620-21.

305. *Id.* at *17, *reprinted in* 14 DEL. J. CORP. L. at 621.

306. *Id.* at *32, *reprinted in* 14 DEL. J. CORP. L. at 627.

307. *Id.*

308. *Id.* at *33, *reprinted in* 14 DEL. J. CORP. L. at 628. At an August 1989 hearing on the approval of a settlement in litigation relating to Champion Industries, Chancellor Allen stated, "Every time there is an announced offer, there is an industry of class action lawyers who will file a suit, even when a board is fully independent and fully functioning to meet its obligations." Even though Allen approved the settlement in that case, his remarks were taken as a warning by the plaintiffs' bar. Borden, *supra* note 274, at 68.

sel's having filed suit after the exchange offer had closed, he was entitled to some award for the substantial assistance he had rendered the court.[309]

Behind Allen's award of fees to Barkan's counsel was a concern to preserve the legitimacy of shareholder litigation by deterring litigation designed primarily to extract attorney's fees from a settlement. He stated that he did "not wish to encourage the premature filing of suits . . . as recognizing the claim of parties filing such premature suits to exclusive representation of the class (before a class action determination has been made) would do."[310] By awarding fees to Barkan's counsel, who had waited to file suit until after the transaction had reached a more mature stage, Allen encouraged the responsible use of shareholder litigation.

VI. THE SEARCH FOR LEGITIMACY II: THE TAKEOVER CASES

> Our corporation law exists, not as an isolated body of rules and principles, but rather in a historical setting and as a part of a larger body of law premised upon shared values. To acknowledge that directors may employ the recent innovation of "poison pills" to deprive shareholders of the ability effectively to choose to accept a noncoercive offer, after the board has had a reasonable opportunity to explore or create alternatives, or attempt to negotiate on the shareholders' behalf, would, it seems to me, be so inconsistent with widely shared notions of appropriate corporate governance as to threaten to diminish the legitimacy and authority of our corporation law.[311]

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In the context of shareholder voting and shareholder suits, the focus of concerns about legitimacy is on the effectiveness of these mechanisms to hold directors accountable. That concern is also present in the context of a target's directors' response to a threatened

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309. The award of attorney's fees to Barkan's counsel is especially understandable in view of the facts that plaintiffs' counsel sought no discovery, did not file an amended pleading attacking the new (and reduced offer), never made an application for a preliminary injunction, and allowed the settlement consideration to be blended into the terms of the exchange offer. *Amsted Indus.*, No. 8224, 1988 Del. Ch. LEXIS 116, at *17, *reprinted in* 14 DEL. J. CORP. L. at 621.

310. *Id.* at *33-34, *reprinted in* 14 DEL. J. CORP. L. at 628.

311. *Interco*, 551 A.2d at 799-800.

hostile takeover, since the market for corporate control has been thought to function as an effective way in which shareholders can hold directors accountable.[312] But the directors' response also implicates the authority that Delaware law grants them to manage the business and affairs of the corporation. In the takeover cases, as in the cases discussed earlier, Chancellor Allen broadly defers to the board's authority to manage the corporation's business and affairs. However, his concern for legitimacy leads him not only to delineate the realm within which directors legitimately exercise their authority but, more importantly, to specify the boundaries beyond which directorial action is no longer legitimate.

The beginning of Allen's analysis of directors' responses to tender offers and the like is section 141(a) of the Delaware General Corporation Law. This section confers broad authority on directors: "The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . ."[313] There remains, however, the additional question of the "scope" of the authority thereby conferred; that is, how does one distinguish those decisions that the directors may legitimately make from those which exceed the limits of their authority? The theory that emerges from Chancellor Allen's cases answering this question is sketched below, then more fully elaborated in a discussion of his major opinions.

Chancellor Allen emphasizes that Delaware law confers on directors the authority to manage the corporation's *business and affairs*. Directors thus legitimately make decisions regarding such matters as the corporation's financing, investments, and sales of assets.

The authority conferred on directors does not extend to actions that do not relate to the corporation's business and affairs. As stated above in the discussion of shareholder voting, a board lacks authority (absent a compelling justification) to take actions whose principal purpose is to impede the effective exercise of the shareholder franchise. Such actions by directors are not authorized, because they relate to the allocation of power between shareholders and directors, not to the corporation's business and affairs.

Similarly, a board has only limited authority to implement and maintain control devices, such as poison pills. Such devices lack an

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312. Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1169 (1981).

313. DEL. CODE ANN. tit. 8, § 141(a) (1991).

independent business purpose and function principally to keep control of the corporation in the hands of the directors. Control devices may, however, legitimately be used in special circumstances. For example, they may legitimately be used for the limited purpose of promoting shareholder welfare; when used in this manner they may not be maintained after they have served that purpose.[314]

Allen believes that the legitimacy of corporate law would be diminished if courts upheld directorial actions that principally affected the allocation of power between directors and shareholders, rather than the corporation's business and affairs. The remainder of this part is devoted to a discussion of the two lines of cases, deriving from the *Unocal*[315] and *Revlon*[316] decisions, in which Chancellor Allen has explained this distinction and developed its implications.[317]

A. Unocal

1. The State of Affairs in 1985

Chancellor Allen became chancellor in 1985, "a watershed year in Delaware jurisprudence."[318] The wave of takeover-related litigation

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314. It is possible that control devices may legitimately be used to protect a corporation's long term business strategy, though Allen has not yet had to confront this issue. *Time*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,284 n.22, *reprinted in* 15 DEL. J. CORP. L. at 749 n.22 (noting that deciding not to redeem a poison pill, "which by definition is a control mechanism and not a device with independent business purposes," because it may present different considerations from a situation in which shareholder choice is precluded by a corporation's merger in conformity with long-term business strategy), *aff'd*, 571 A.2d 1140 (Del. 1989). *Cf.* Sutton Holding Corp. v. Desoto, Inc., [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,012 (Del. Ch. May 14, 1991) (noting that concern for legitimacy presents an "underlying reason for shareholder elections"), *reprinted in* 17 DEL. J. CORP. L. 363 (1992) (holding that board's insertion of change of control provision in pension plan presumptively constitutes breach of duty of loyalty where, like poison pill, provision was designed to deter a change in control, not to create useful rights).

315. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

316. Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173 (Del. 1985).

317. Since the facts of these two cases and their progeny have been extensively discussed, the presentations of facts will be kept to a minimum.

318. 21ST ANNUAL INSTITUTE, *supra* note 6, at 261 (comments of E. Norman Veasey, a partner at the Wilmington law firm of Richards, Layton & Finger, P.A.).

had begun to accelerate the year before[319] and the direction in which Delaware law would develop was unclear.[320]

The first of 1985's landmark hostile takeover cases was *Unocal Corp. v. Mesa Petroleum Co.*[321] Because of "the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders," a board's response to a tender offer is not automatically entitled to the protection of the business judgment rule.[322] To be entitled to its protection, a target board must satisfy two conditions. First, the directors "must show that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership."[323] Second, there is the element of balance: "If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed. This entails an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise."[324]

Unocal set the terms for much of the takeover-related litigation that followed. Chancellor Allen took seriously the supreme court's admonition that an "omnipresent specter" of self-interest surrounds board decisions to resist a tender offer. Indeed, he credited the Delaware Supreme Court with being "the first court to recognize that litigation arising from steps taken to defeat a proposed acquisition of corporate control involved considerations not present in the simpler cases involving board decisions concerning the business operations of the firm."[325] Allen's subsequent cases demonstrate that he saw

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319. John C. Coffee, Jr., *Shareholders Versus Managers: The Strain in the Corporate Web*, *in* KNIGHTS, RAIDERS, AND TARGETS 77 (John C. Coffee, Jr. et al. eds., 1988).

320. In his review of Delaware corporate law, Professor Hamilton merely noted the recent supreme court opinion in Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985), but was unable to speculate on its possible development. Robert W. Hamilton, *The State of State Corporation Law: 1986*, 11 DEL. J. CORP. L. 3, 9-10, 24 (1986).

321. 493 A.2d 946 (Del. 1985). *See generally* Gregg H. Kanter, Comment, *Judicial Review of Antitakeover Devices Employed in the Noncoercive Tender Offer Context: Making Sense of the* Unocal *Test*, 138 U. PA. L. REV. 225, 274 (1989) (proposing a reformulation of the *Unocal* test which satisfies the Delaware Supreme Court's intermediate standard of review and also the need for uniformity and predictability in the law).

322. *Unocal*, 493 A.2d at 954.

323. *Id.* at 955.

324. *Id.*

325. William T. Allen, *Investment Bankers' and Judicial Review of Corporate Action to Defeat Hostile Takeovers: Comments on Chapter 6*, *in* BATTLE FOR CORPORATE CONTROL, *supra* note 6, at 135.

Unocal as giving effect to this concern about self-interest and that he believed the test enunciated therein should be used to scrutinize and, in some cases, invalidate defensive responses to takeovers.

2. Early Interpretations of *Unocal*

The chancery court's initial opportunity to give meaning to *Unocal* arose in the context of a struggle for control of Anderson, Clayton & Co. (Anderson, Clayton) between incumbent management and a group of shareholders, Bear, Stearns & Co., Inc., Sterns & Co., Inc., Gross Petroleum Corp., and Gross Partners (collectively BS/G), who made a hostile offer for any and all shares.[326] Anderson, Clayton's Board approved a recapitalization that involved a cash distribution of $37 per share and the issuance of a stub share estimated to trade initially in the $6-$10 range.[327] Shareholders challenged the recapitalization and sought a preliminary injunction against its implementation, which Chancellor Allen eventually granted.[328]

Matters were dormant until August 21, 1986, when BS/G announced a tender offer for any and all shares of Anderson, Clayton at $56 cash per share.[329] The following day Anderson, Clayton commenced a self-tender offer for approximately 65% of its outstanding stock at $60 cash per share.[330] Allen described this alternative transaction (the "Company Transaction") as "a continuation in another form of a recapitalization of the Company that had been approved by the Company's Board in February, 1986."[331] Plaintiffs then sought a preliminary injunction against implementation of the Company Transaction.

While Allen's initial, and crucial, decision was to apply *Unocal*,[332] his grounds for finding that its first prong was satisfied are curious and suggestive of the difficulties courts have had in interpreting

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326. *See In re* Anderson, Clayton Shareholders Litig., 519 A.2d 669 (Del. Ch. 1986); Meyers, *supra* note 4, at 72 (stating that the chancery court fomented its "intellectual revolution" against the Delaware Supreme Court with Chancellor Allen's opinions in cases arising from struggle for control of Anderson, Clayton).

327. *Anderson, Clayton*, 519 A.2d at 672.

328. *Id.* at 671-72, 674. The basis of this decision was that the shareholder vote approving the recapitalization was fatally flawed by misleading statements made by Anderson, Clayton's management. *Id.* at 679.

329. AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 104 (Del. Ch. 1986).

330. *Id.*

331. *Id.* at 104-05.

332. *Id.* at 112.

Unocal.[333] The self-tender was not justified as a response to a "threat" posed by BS/G's "inherently unfair" offer, in the way that two-tier offers are understood to be unfair and coercive.[334] Allen instead found *Unocal*'s first prong to have been met because he interpreted its "danger to corporate policy or effectiveness" requirement "to be simply a particularization of the more general requirement that a corporate purpose, not one personal to the directors, must be served by the stock repurchase."[335] Additionally, he found plausible the defendants' account of the Company Transaction as being designed to permit the shareholders to "have the benefits of a large, tax-advantaged cash distribution together with a continuing participation in a newly-structured, highly-leveraged Anderson, Clayton."[336]

While defendants thus satisfied *Unocal*'s first prong, in their attempt to satisfy its second prong they were hoisted on the petard of their own claim that all they had done was "create an option for shareholders."[337] Anderson, Clayton timed its self-tender so that even a shareholder who preferred the BS/G offer could not tender into it because of the risk of missing the lucrative front-end of the Company Transaction, should the BS/G offer not close.[338] While purporting to have merely created another option for shareholders, Anderson, Clayton's directors had structured their self-tender effectively to coerce shareholders into accepting it. Failing to satisfy *Unocal*'s second prong, the Company Plan did not qualify for the protections of the business judgment rule and was unlikely to satisfy the more stringent entire fairness standard.[339] Chancellor Allen thus granted plaintiffs' motion for a preliminary injunction against its implementation.[340]

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333. A recent commentator has argued that in *AC Acquisitions*, the court, recognizing the inconsistency between the literal meaning of the first prong of the *Unocal* test and its underlying policy considerations, replaced *Unocal*'s literal test with a "valid corporate purpose" test based upon policy considerations. Kanter, *supra* note 321, at 249-50.

334. *AC Acquisitions*, 519 A.2d at 112.

335. *Id.*

336. *Id.*

337. *Id.* at 113.

338. *Id.*

339. *Id.* at 114-15. Under the "entire fairness" standard, defendant bears burden of establishing the entire fairness of challenged transaction, which includes both fair price and fair dealing. *See* Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983).

340. Between Chancellor Allen's opinions in *AC Acquisitions* and City Capital Assocs. v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988), Vice-Chancellor Jacobs decided the important case of Robert M. Bass Group, Inc. v. Evans, 552 A.2d

3. The Radical Turn in Late 1988

The corporate world shook on November 1, 1988,[341] when Chancellor Allen issued his opinion in *City Capital Associates v. Interco Inc.*[342] The case involved a struggle for control precipitated by the Interco Board's rejection of an offer by City Capital Associates (CCA) for a friendly merger and of CCA's August 15th tender offer for all of Interco's outstanding stock at $70 cash per share.[343] The board also refused to redeem Interco's recently adopted poison pill rights plan.[344] By October 18, CCA had raised its all-cash, all-shares offer to $74.[345] Interco's Board rejected that offer as inadequate and asserted that its own planned restructuring would yield shareholder value of at least $76 per share.[346] CCA filed suit, seeking an injunction requiring the Interco Board to redeem its poison pill and restraining further steps to implement the restructuring, including any steps to sell Ethan Allen, Interco's "crown jewel."[347]

Chancellor Allen applied the standard enunciated in *Unocal*, which he lauded as "the most innovative and promising case in our recent corporation law."[348] Turning to *Unocal*'s first prong, Allen observed that any threat posed by an all-cash, all-shares offer "is not importantly [sic] to *corporate policies*," but that tender offers of this form could pose two kinds of threats to *shareholder interests*.[349]

1227 (Del. Ch. 1988), in which he followed the Chancellor's lead in finding that a defensive restructuring undertaken by management of Macmillan, Inc. failed to satisfy the *Unocal* standard.

In the period between *AC Acquisitions* and *Bass*, the Delaware Supreme Court applied the *Unocal* standard in evaluating a defensive action taken by the Newmont Mining Corporation in response to a hostile tender offer by T. Boone Pickens. Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987). *Newmont Mining* added little to the jurisprudence of *Unocal*, except to suggest that the Delaware Supreme Court did not intend it to be applied as vigorously as Allen had done in *AC Acquisitions*. *See, e.g.*, Scott P. Towers, Comment, Ivanhoe Partners v. Newmont Mining Corp.—*The* Unocal *Standard: More Bark than Bite?* 15 DEL. J. CORP. L. 483, 538 (1990) (concluding that "*Ivanhoe* clearly suggests that the restrictions on the business judgment rule's applicability in the takeover context are relatively slight, and the *Unocal* standard may have more bark than bite").

341. Meyers, *supra* note 4, at 67, 75 (Allen's *Interco* opinion "startled" and "immediately became the talk of the financial world").

342. 551 A.2d 787 (Del. Ch. 1988).

343. *Id.* at 791-92.

344. *Id.* at 789, 792.

345. *Id.* at 794.

346. *Id.*

347. *Id.*

348. *Id.* at 796.

349. *Id.* at 797 (emphasis added).

The structure of an offer, such as the front-end loaded, partial offers in *Unocal*[350] and *Ivanhoe Partners v. Newmont Mining Corp.*,[351] could render it coercive, and thus pose a threat to the voluntariness of shareholders' choice.[352] CCA's offer did not present a threat on this basis, since the offer was all cash for all shares.

Structurally noncoercive but "inadequate" offers could also pose a threat to shareholder interests, though only

> in the special sense that an active negotiator with power, in effect, to refuse the proposal may be able to extract a higher or otherwise more valuable proposal, or may be able to arrange an alternative transaction or a modified business plan that will present a more valuable option to shareholders.[353]

Such considerations may justify leaving a poison pill in place "for a period while the board exercises its good faith business judgment to take such steps as it deems appropriate to protect and advance shareholder interests in light of the significant development that such an offer doubtless is."[354] But in most instances there comes a point at which "the legitimate role of the poison pill in the context of a noncoercive offer will have been fully satisfied."[355]

Applying this analysis, Allen concluded that the only threat posed by the CCA offer was that Interco's investment bankers "*may be correct in their respective valuations of the offer and the restructuring but a majority of the Interco shareholders may not accept that fact and may be injured as a consequence.*"[356] Since such a threat is "far too mild" to justify the directors in permanently foreclosing shareholders from accepting the offer, the board's failure to redeem the rights could not be justified under *Unocal*.[357]

By emphasizing that poison pills were a "recent innovation,"[358] Allen contrasted their use with traditional board actions, and highlighted concerns about the legitimacy of the board's action in retaining

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350. 493 A.2d 946 (Del. 1985).
351. 535 A.2d 1334 (Del. 1987).
352. *Interco*, 551 A.2d at 797.
353. *Id.* at 798.
354. *Id.*
355. *Id.* (footnote omitted).
356. *Id.*
357. *Id.*
358. *Id.* at 799.

the pill. Decisions to enact and retain a poison pill are quite different from decisions, like those about the corporation's financing, investments, and sale of assets, that traditionally fall within the board's section 141(a) authority to manage the corporation's business and affairs. In the circumstances that *Interco* presented, Allen concluded that the board's retention of the pill did not fall within the scope of the board's legitimate authority to act.[359]

Even when making a revolutionary holding forcing redemption of a poison pill for the first time in the history of Delaware corporate law, Allen still showed broad deference to Interco's directors in managing the business and affairs of the company by refusing to enjoin the sale of Ethan Allen. A decision to sell assets, unlike one to retain a poison pill, falls within Chancellor Allen's understanding of the directors' authority to manage the corporation.[360] Chancellor Allen recognized that refusing to enjoin the sale complicated things for CCA and might imperil its ability to complete the transaction, but he emphasized that an offeror "has no right to demand that its chosen target remain in status quo while its offer is formulated, gradually increased and, perhaps, accepted."[361]

Interco created an immediate furor.[362] Martin Lipton, a prominent counsel for corporations resisting hostile tender offers, circulated a memorandum urging his clients to consider reincorporating in states other than Delaware.[363] A number of takeover attorneys believed that Chancellor Allen's decision would be reversed by the Delaware Supreme Court.[364] However, the appeal was dismissed on grounds of mootness.[365]

There are several reasons why *Interco* elicited such a strong response. Allen's analysis of *Unocal*, apparently influenced by the

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359. *Id.* at 800.

360. *Id.* at 801.

361. *Id.*

362. Meyers, *supra* note 4, at 75. *Interco*'s shock value was enhanced by Chancellor Allen's evident skepticism toward the target's investment bankers' ability to elevate their "reference ranges" for the company's value over the course of just a few weeks. *Interco*, 551 A.2d at 792. He also criticized the bank's compensation arrangement, noting that it gave the bank "a rather straightforward and conventional conflict of interest when it opines that the inherently disputable value of its restructuring is greater than the all cash alternative offered by plaintiffs." *Id.* at 793.

363. *See, e.g.*, Meyers, *supra* note 4, at 75; Parloff, *supra* note 5, at 34.

364. Meyers, *supra* note 4, at 75.

365. Interco Inc. v. City Capital Assocs., 556 A.2d 1070 (Del. 1988).

draft article by Gilson and Kraakman,[366] was thorough and persuasive. The supreme court's application of *Unocal* in *Newmont Mining*[367] had been anemic and conclusory, and invited the question of why the court had enunciated a new, "intermediate" standard of review if in virtually every case it would result in board action being protected by the business judgment rule.[368] Allen answered that question in *Interco* by propounding a robust and plausible view of *Unocal*, an interpretation that took seriously its warning about the omnipresent spectre of self-interest.

Allen's opinion in *Interco* also seemed to strike just the right balance between a board's lack of legitimate authority to act in ways principally designed to affect the balance of power between directors and shareholders and its legitimate authority to manage the corporation's business and affairs. While he ordered redemption of the poison pill, Allen expressly did not enjoin the sale of Ethan Allen and insisted that an offeror has no right to "freeze" a target's operations.

A final reason for the overwhelming response was the concern of where the opinion might lead. If a board of directors can not indefinitely maintain a poison pill to protect a defensive restructuring, what limits are there on tender offerors' abilities to reshape corporate life? Observers did not have to wait long for such consequences to be revealed; only a month and a half after the *Interco* decision, Justice Duffy followed Chancellor Allen's lead in his decision in *Grand Metropolitan PLC v. Pillsbury Co.*[369]

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366. *Interco*, 551 A.2d at 796 n.8 (citing the July 28, 1988 draft of an article eventually published as Gilson & Kraakman, *Delaware's Intermediate Standard*, *supra* note 8).

367. Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987).

368. *See* Polk v. Good, 507 A.2d 531, 536-39 (Del. 1986) (applying business judgment rule to board's decision to pay "greenmail"); *Moran*, 500 A.2d at 1350 (applying business judgment rule to board's adoption of a poison pill). *But see Revlon*, 506 A.2d at 184 (holding that business judgment rule does not protect a board's defensive measure after the break-up of the corporation is inevitable).

369. 558 A.2d 1049, 1060 (Del. Ch. 1988) ("I agree with the Chancellor's analysis in *Interco*, much of which I have followed."). *See* Robert A. Prentice & John H. Langmore, *Hostile Tender Offers and the "Nancy Reagan Defense": May Target Boards "Just Say No"? Should They be Allowed To?*, 15 DEL. J. CORP. L. 377, 394 (1990) ("*Pillsbury* can most simply be perceived as a reaffirmation of the *Interco* ruling . . . .").

4. Retrenchment in 1989: The End of the 1980s and the Beginning of the 1990s

a. *TW Services*

Chancellor Allen's holding in his March 1989 opinion in *TW Services, Inc. v. SWT Acquisition Corp.*,[370] i.e., that a decision to enter into a merger agreement is protected by the business judgment rule, is both straightforward and entirely consistent with his view that a board acts legitimately when its decisions relate to the corporation's business and affairs. But in terms of its holding, the opinion could have been a third its length. One wonders why Allen devoted two-thirds of the opinion to dicta on the nature of the corporation and the directors' responsibilities.

Allen seems to have been troubled by what his own decisions in *AC Acquisitions*[371] and *Interco* had wrought. Together with *Robert M. Bass Group, Inc. v. Evans*[372] and *Grand Metropolitan PLC v. Pillsbury Co.*,[373] the four decisions seem to have created a line of decisions in which the chancery court had enjoined targets from precluding shareholders' acceptance of a non-coercive tender offer once the target's board had a reasonable time in which to respond. Prior to *TW Services*, the proper interpretation of these cases seemed consistent with the analysis of *Unocal* offered by Gilson and Kraakman,[374] according to which a target board's response to a non-coercive tender offer, whether it be a defensive restructuring or failure to redeem a poison pill, fails to satisfy *Unocal*'s proportionality requirement unless the target's board offers convincing reasons for the superiority of its plan over that of the tender offeror.[375] A central assumption of the analysis was that directors may not sacrifice shareholder interests to the interests of other possible corporate "constituencies" in responding to a hostile tender offer.[376]

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370. [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,173 (Del. Ch. Mar. 2, 1989), *reprinted in* 14 DEL. J. CORP. L. 1169 (1989).

371. 519 A.2d 103 (Del. Ch. 1986).

372. 552 A.2d 1227 (Del. Ch. 1988).

373. 558 A.2d 1049 (Del. Ch. 1988).

374. *Delaware's Intermediate Standard*, *supra* note 8.

375. *Id.* at 270-71.

376. Gilson and Kraakman state:

Management is no more free to sacrifice shareholder interests to those of other corporate constituencies in responding to a hostile offer than it is

In the period between *Interco* and *TW Services*, Allen appears to have begun to doubt the primacy (and virtual exclusivity) that he had earlier accorded to shareholder interests. At the oral argument in *TW Services*, he repeatedly returned to the issue of constituencies, which "obviously gets very close to the epicenter of these problems,"[377] and engaged in a "broad level of discussion" with counsel on the question of which constituencies a board may properly consider.[378] Chancellor Allen emphasized that he was pursuing the constituency issue because of a general interest in the problem, and that he did not "want to be understood to be implying anything about this board in this case."[379] Allen was clearly attracted to the notion that a board may properly consider constituencies other than shareholders, though he expressed concern that if a board is "responsible to everyone," its decisions may become virtually unreviewable, yet "it seems that there ought to be some institution to have review at some point."[380]

But however attractive the idea that directors may properly take into account constituencies other than shareholders in responding to a takeover may be in theory, if the proper interpretation of the four cases is that a board ultimately lacked authority to take actions that precluded shareholder acceptance of a tender offer, then Delaware law would have foreclosed further development of that idea.

Allen instead offered an interpretation according to which *AC Acquisitions*, *Interco*, *Bass*, and *Pillsbury* each involved a defensive restructuring that was the "functional alternative" of the offer claimed to pose a threat.[381]

> free to favor one participant over all others in an ongoing bidding contest. Any different understanding of management's fiduciary obligation to shareholders would render most of corporate law incoherent.

Id. at 267 n.65.

377. Argument on SWT Acquisition and Class Plaintiffs' Motions for Preliminary Injunction at 58-67, TW Servs., Inc. v. SWT Acquisition Corp., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,173 (Del. Ch. Mar. 2, 1989) (transcript of hearing on Jan. 31, 1989).

378. *Id.* at 67.

379. *Id.* at 63, 67.

380. *Id.* at 67.

Chancellor Allen's remarks at the end of the oral argument suggest that he believed the case presented issues that he may previously have neglected in deciding similar cases: "I have been frowning during the argument probably a little more than is my nature. It is because I feel for some reason in this case a little more than in cases that are not in some ways dissimilar to it the burden of the decision." *Id.* at 104.

381. *TW Servs.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,180, *reprinted in* 14 DEL. J. CORP. L. at 1187.

> In those Delaware cases that have factually involved preponderant shareholder acceptance of a hostile tender offer, boards have, responding to their own view of their duty, proposed an alternative transaction—a management endorsed breakup transaction that, realistically viewed, constituted *a functional alternative* to the resisted sale.[382]

So interpreted, those cases do not foreclose the possibility that Delaware law might indefinitely sanction a board's authority effectively to preclude shareholders from accepting a hostile takeover bid because other constituencies would be adversely affected if the takeover bid were to succeed. As Allen stated:

> Those cases, however, offer no judicial opinion on the question when, if ever, will a board's duty to "the corporation and its shareholders" require it to abandon concerns for "long term" values (*and other constituencies*) and enter a current share value maximizing mode. This, however, is the question referred to above that is raised by this case but need not now be decided in light of the particularities of the circumstances the directors of TW face.[383]

Yet, *TW Services* may also be understood as the development of an attempt to distinguish the circumstances in which board actions that restrict shareholder ability to accept a hostile tender offer are legitimate from those in which they are illegitimate. Following this

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382. *Id.* at 92,180, *reprinted in* 14 DEL. J. CORP. L. at 1186-87 (emphasis added) (footnote omitted). This characterization of the four cases raises several questions. First, in each case were the transactions that the target proposed the "functional equivalent" of the bidder's proposal? The characterization is most apt for *Bass*, where the management and bidder restructurings were identical, except with respect to ownership of the 39% interest in MAC Information Corporation. It seems considerably less apt for the other three cases. In *AC Acquisitions*, management defended the Company Transaction on the ground that it was *not* equivalent to the bidder's proposal, since the Company Transaction would leave shareholders "a continuing participation" in the corporation. *AC Acquisitions*, 519 A.2d at 112. Chancellor Allen himself stated that it is "unquestionably correct" that "a rational shareholder might prefer the Company Transaction." *Id.* If a rational shareholder could prefer either transaction, then they are *not* "functionally equivalent."

Second, is viewing these cases as involving a target's response that is "functionally equivalent" to the tender offeror's proposal the best interpretation? Or should we see them as saying that a target cannot preclude shareholder choice after a reasonable amount of time has lapsed, whether or not the target has chosen to respond by a restructuring or other defensive maneuver?

383. *TW Servs.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,180, *reprinted in* 14 DEL. J. CORP. L. at 1187 (emphasis added).

approach, Allen is stating that a board acts illegitimately when it attempts to preclude shareholder choice by adopting a management endorsed breakup transaction that is the functional equivalent of the bidder's plan. Such transactions, like the continued retention of a poison pill in circumstances such as those in *Interco*, do not fall within the board's traditional authority to manage the corporation's business and affairs. Considering *AC Acquisitions*, *Interco*, *Bass*, and *Pillsbury* under this approach, it is still possible that Delaware law might indefinitely sanction a board's authority to preclude shareholders from accepting a hostile takeover bid because of beliefs about the corporation's long-term interests. In *Interco*, Chancellor Allen had already displayed, through his refusal to enjoin the sale of Ethan Allen, his broad deference to board authority even when its decisions made a tender offer less likely. In *Paramount Communications, Inc. v. Time Inc.*,[384] he took the next logical step, i.e., he held that a board acts legitimately in pursuing a long-term business plan, even when pursuit of the plan forecloses shareholder opportunity to accept a premium tender offer.

b. *Time*

The Delaware Supreme Court found its opportunity to review the direction in which the chancery court had developed the *Unocal* standard in *Paramount Communications, Inc. v. Time Inc.*[385] On March 3, 1989, the Time and Warner Boards approved a stock-for-stock merger between Warner and a wholly-owned subsidiary of Time.[386] Delaware law did not require approval by Time shareholders, though New York Stock Exchange rules required that Time's issuance of shares to effectuate the merger be approved by its stockholders.[387] On June 7, 1989, Paramount announced an all-cash, all-shares $175 per share tender for Time.[388] The offer was later raised to $200 per share.[389] Time's Board rejected Paramount's offer and decided to "reformat"

384. [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,264 (Del. Ch. July 14, 1989) (Revised July 17, 1989), *reprinted in* 15 DEL. J. CORP. L. 700 (1990).

385. 571 A.2d 1140 (Del. 1989).

386. *Id.* at 1146.

387. *Id. See* Portia Policastro, Note, *When Delaware Corporate Managers Turn Auctioneers: Triggering the* Revlon *Duty After the* Paramount *Decision*, 16 DEL. J. CORP. L. 187, 220 n.188 (1991) (describing voting requirements).

388. *Time*, 571 A.2d at 1147.

389. *Id.* at 1149.

its transaction into an outright cash and securities acquisition of Warner by Time, which did not require any vote by Time shareholders.[390] Paramount (and certain Time shareholders) filed suit in the chancery court seeking a preliminary injunction to halt Time's tender offer for 51% of Warner's outstanding shares at $70 cash per share.[391] The principal claim was that Time's directors had breached their *Unocal* duties.[392]

In applying *Unocal*'s first prong, Chancellor Allen confronted plaintiffs' argument that his own opinion in *Interco* (and Justice Duffy's *Pillsbury* opinion) established that an

> all cash, all shares offer falling within a range of value that a shareholder might reasonably prefer, to be followed by a prompt second-step merger for cash, could not, so long as it involved no deception, be construed as *a sufficient threat to shareholder interests* to justify as reasonable board action that would permanently foreclose shareholder choice to accept that offer.[393]

Allen maintained that *Interco* (and *Pillsbury*) did not "establish that Time, as a corporate entity, ha[d] no distinct legally cognizable interest that the Paramount offer endanger[ed]."[394] While an all-cash, all-shares offer, with the promise of a prompt back-end merger, does not pose a sufficient threat *to shareholders* to warrant permanently foreclosing shareholder choice, such an offer might pose a threat to the target *as a corporate entity*. At this point, Allen's emphasis on the "functional equivalence" of transactions as discussed in *TW Services*[395] becomes relevant.

Allen distinguished the cases on which plaintiffs relied—*AC Acquisitions*, *Bass*, *Interco*, and *Pillsbury*—on the grounds that in each of those cases "management was presenting and seeking to 'cram down' a transaction that was *the functional equivalent* of the very leveraged 'bust up' transaction that management was claiming presented a

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390. *Id.*

391. *Time*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,265, *reprinted in* 15 DEL. J. CORP. L. at 706.

392. *Time*, 571 A.2d at 1142. The shareholder plaintiffs also asserted a *Revlon* claim. *Id. See* discussion *infra* text accompanying notes 405-55.

393. *Time*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,282, *reprinted in* 15 DEL. J. CORP. L. at 746 (emphasis added).

394. *Id.* at 93,283, *reprinted in* 15 DEL. J. CORP. L. at 747.

395. [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,173 (Del. Ch. Mar. 2, 1989), *reprinted in* 14 DEL. J. CORP. L. 1169 (1989).

threat to the corporation."[396] The facts in *Time* were different in two respects.

First, the Time-Warner merger had its origins in *bona fide* business purposes, not in questions of corporate control.[397] Thus, even though the merger may have had the practical effect of precluding shareholder choice, it represented a legitimate exercise of the board's authority to manage the corporation's business and affairs.

Second, the Time-Warner merger was not an "alternative to the sale Paramount propose[d] (*i.e.*, the functional equivalent) in the way the enjoined transactions in the cited cases can be said to be equivalents of sales."[398] This is significant because when a target engages in a transaction that is the "functional equivalent" of the bidder's plan, the target cannot claim that the offer poses a threat to the corporation, as the corporation has embarked on a plan that has the same consequences for the corporation as the bidder's. But when the target has not embarked on a "functionally equivalent" plan, for example when it continues to pursue a pre-existing business plan, there remains a distinct corporate interest that can be threatened even by an all-cash, all-shares tender offer. Allen maintained that the latter situation was present in *Time* because the merger with Warner was a continuation of Time's long-term business strategy.[399]

Unocal's second prong was satisfied because the defensive steps were effective to thwart Paramount's threat, but were not overly broad. They also did not preclude, though admittedly they made more difficult, a hostile takeover of the merged company. Allen thus refused to grant an injunction against Time's tender offer for Warner shares, concluding that by entering into the merger agreement, the

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396. *Time*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,283, *reprinted in* 15 DEL. J. CORP. L. at 747. *See id.* at 93,278, *reprinted in* 15 DEL. J. CORP. L. at 735-36 (citing Delaware Court of Chancery cases permitting shareholders to choose between "two functionally equivalent alternative transactions").

397. *Id.* at 93,283, *reprinted in* 15 DEL. J. CORP. L. at 747.

398. *Id.*

399. *Id.* at 93,283, *reprinted in* 15 DEL. J. CORP. L. at 748. Allen states the underlying principle when he says:

> where the board has not elected explicitly or implicitly to assume the special burdens recognized by *Revlon*, but continues to manage the corporation for long-term profit pursuant to a preexisting business plan that itself is not primarily a control device or scheme, the corporation has a legally cognizable interest in achieving that plan.

Id.

Time Board had exercised "*perfectly conventional powers* to cause the corporation to buy assets for use in its business."[400]

The Delaware Supreme Court affirmed Chancellor Allen's denial of an injunction against the tender offer. As for *Unocal*'s first prong, the court disapproved of plaintiffs' argument that a hostile tender offer can pose only the threat of coercion and the threat of inadequate value. The court held that such a construction of *Unocal* was too "narrow and rigid."[401] The court further stated:

> Plaintiffs' position represents a fundamental misconception of our standard of review under *Unocal* principally because it would involve the court in substituting its judgment as to what is a "better" deal for that of a corporation's board of directors. To the extent that the [c]ourt of [c]hancery has recently done so in certain of its opinions, we hereby reject such approach as not in keeping with a proper *Unocal* analysis. *See, e.g.*, *Interco* and its progeny; *but see TW Services, Inc. v. SWT Acquisition Corp.*[402]

The court thus implies, without directly asserting, that in *Interco*, Chancellor Allen had substituted his judgment for that of the corporation's board of directors. This seriously misrepresents Allen's opinion. Allen did not substitute his judgment for that of the Interco Board, but rather, in light of Interco's own investment advisors' estimate of the small difference between the CCA offer and the planned restructuring, he concluded that *Interco*'s shareholders might prefer CCA's offer.

Having stated its general views about "threats," the court identified three alleged threats that the Paramount offer posed *to the shareholders*.[403] Despite these threats, at no point did the court engage the argument that the decision was the shareholders'. Further, the court conspicuously failed to address Chancellor Allen's argument

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400. *Id.* at 93,284, *reprinted in* 15 DEL. J. CORP. L. at 749 (emphasis added).

401. *Time*, 571 A.2d at 1153. If the supreme court disapproves of this "narrow and rigid" construction, then what is *Unocal*? A plausible view is that the supreme court no longer wants to make *Unocal* an effective intermediate standard. *Cf.* Trevor S. Norwitz, "*The Metaphysics of Time*": *A Radical Corporate Vision*, 46 BUS. LAW. 377, 381 (1991) (concluding that a broad grant of deference at both stages of the *Unocal* test seems to render the requirement, that a board's response be reasonable, "virtually vacuous").

402. *Time*, 571 A.2d at 1153 (citations omitted).

403. *Id.*

that the Paramount offer threatened corporate, not shareholder, interests.

The supreme court affirmed Chancellor Allen's finding that Time's response was reasonable. However, it did so grudgingly, noting without any apparent support that the chancellor had "blurred somewhat the discrete analyses required under *Unocal*."[404]

B. Revlon

Two key issues have emerged as foci of the *Revlon* duty to maximize immediate share value, which applies when the objective of preserving "the corporate entity" is no longer obtainable or has been abandoned by the board.[405] First, what circumstances "trigger" a board's entering the *Revlon* mode? Second, what are a board's obligations under *Revlon*?

Chancellor Allen has played a central role in defining the terms of the debate about the proper interpretation of *Revlon*. His decisions at crucial junctures of the analysis reflect his concerns about certainty and legitimacy in corporate law. His concern with certainty is most evident in his characterization of the *Revlon* "trigger." The criterion that Allen developed over a number of cases, whether the transaction

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404. *Id.* at 1154. The court's criticism is ironic in view of the fact that its own analysis of the reasonableness of the response was substantially identical to Chancellor Allen's. *Compare id.* at 1154-55 *with Time*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,283-84, *reprinted in* 15 DEL. J. CORP. L. at 748-49.

The supreme court's description of Allen's opinion as lacking clarity is especially ironic in view of the lack of clarity in the supreme court opinion. For example, one commentator refers to a "central (but somewhat nebulous) passage," Norwitz, *supra* note 399, at 385; and to the fact that "Justice Horsey's opinion is expressed in vague terms, leaving plenty of room for interpretation," *id.* at 386.

405. The crucial passage in *Revlon* states:

> However, when Pantry Pride increased its offer to $50 per share, and then to $53, it became apparent to all that *the break-up of the company* was inevitable. The Revlon board's authorization permitting management to negotiate a merger or buyout with a third party was a recognition that *the company was for sale*. The duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit. This significantly altered the board's responsibilities under the *Unocal* standards. It no longer faced threats to corporate policy and effectiveness, or to the stockholders' interests, from a grossly inadequate bid. The whole question of defensive measures became moot. The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.

Revlon, 506 A.2d at 182 (emphasis added).

in question involves a change of control, provides relatively certain guidance to those planning corporate transactions. His concern with legitimacy is most evident in his discussion of directors' duties once the corporation has entered the *Revlon* mode. In such circumstances a board acts legitimately, even though it exercises substantial discretion over the disposition of the corporation's property, provided that it acts in good faith and with due care.

1. What Triggers *Revlon* Duties?[406]

Chancellor Allen's belief that an actual (or likely) *change in control* triggers *Revlon* is clear from his first post-*Revlon* case, *Freedman v. Restaurant Associates*,[407] in which he observed: "The *Revlon* case recognizes an obligation on the part of a board of directors, *once it is clear to the board that the corporation is to be subject to a change in control*, to attempt to maximize the amount to be received by shareholders."[408]

The Delaware Supreme Court next construed *Revlon*'s trigger in *Ivanhoe Partners v. Newmont Mining Corp.*[409] Newmont Mining was allegedly threatened by a hostile, two-tiered, front-end loaded, inadequate tender offer made by a T. Boone Pickens affiliate.[410] In addition, Newmont Mining perceived a possible takeover threat from Gold Fields, a large shareholder.[411] In response, Newmont declared a large cash dividend (which enabled Gold Fields to make a "street sweep" of Newmont stock),[412] and entered into a standstill agreement with Gold Fields that restricted its stock position to 49.9% and its

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406. Commentators have noted that the crucial *Revlon* passage provides little guidance in determining when "*Revlon* duties" are triggered. *See, e.g.*, Policastro, *supra* note 387, at 202 ("The language of this often-quoted passage leaves uncertain which of the players and which of the transactions caused the Revlon Board of Directors to assume the duty to maximize current share value.").

407. Freedman v. Restaurant Assocs. Indus., Inc., [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,502, at 97,214 (Del. Ch. Oct. 16, 1987), *reprinted in* 13 DEL. J. CORP. L. 651 (1988) (footnote omitted).

408. *Id.* at 97,218-19, *reprinted in* 13 DEL. J. CORP. L. at 661 (emphasis added). A recent commentator notes (citing *Freedman*) that the "Delaware Court of Chancery was quick to recognize that a recapitalization and a formal 'sale' are practically equivalent" and concludes that a transaction triggers *Revlon* only if it involves a sale of control. Policastro, *supra* note 387, at 207. *But see* Barry Reder, *The Obligation of a Director of a Delaware Corporation to Act as an Auctioneer*, 44 BUS. LAW. 275, 280 (1989) (criticizing *Freedman* for improperly extending *Revlon*).

409. 535 A.2d 1334 (Del. 1987).

410. *Id.* at 1339.

411. *Id.* at 1338.

412. *Id.* at 1340.

representation on the board to 40%.[413] The supreme court rejected plaintiffs' argument that the transaction triggered duties under *Revlon*, stating that *Revlon* applied only if sale of the corporation was "inevitable," and finding that the transaction had not resulted in the inevitable sale of Newmont.[414]

The court failed to make clear why the transaction did not trigger *Revlon*.[415] The opinion suggests that the crucial factor was that the transaction did not involve a change in control, but rather was done "to maintain [Newmont's] independent status for the benefit of its other stockholders."[416] This led some to believe that *Newmont Mining* stated a "sale of control" theory of the *Revlon* trigger.[417] Other commentators interpreted it as stating a "breakup" theory.[418]

When the chancery court subsequently decided *In re J.P. Stevens & Co., Inc. Shareholders Litigation*,[419] *In re Fort Howard Corp. Shareholders Litigation*,[420] and *Citron v. Fairchild Camera*,[421] there seemed little reason

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413. *Id.*

414. *Id.* at 1345.

415. Gilson and Kraakman observe that while the result in *Newmont Mining* is clear, "its reasoning is not." *What Triggers* Revlon?, *supra* note 8, at 41.

416. *Newmont Mining*, 535 A.2d at 1344.

417. Judge Longobardi interpreted *Newmont Mining* as stating a change of control criterion in the next important case construing the *Revlon* trigger, Black & Decker Corp. v. American Standard, Inc., 682 F. Supp. 772, 781 (D. Del. 1988). But as some commentators noted, the *Ivanhoe* transaction did transfer effective control to management. *See, e.g.*, Policastro, *supra* note 387, at 211 ("Newmont's defensive measures were as successful as a management buyout or recapitalization in transferring *effective* control to management"); *What Triggers* Revlon?, *supra* note 8, at 41. Thus, if *Newmont Mining* is construed to adopt a change of control criterion, that criterion is limited to circumstances in which an "absolute majority voting block of a company will be sold." Policastro, *supra* note 387, at 189. *See also id.* at 208 (referring to the *Ivanhoe* court as holding that the *Revlon* duty is "not implicated by a corporate sale of less than an absolute majority control block of Newmont stock"). This feature of the opinion leads Gilson and Kraakman to refer to "the apparently narrow formalism of *Ivanhoe*." *What Triggers* Revlon?, *supra* note 8, at 43.

418. *See, e.g.*, Reder, *supra* note 408, at 275, 279; Policastro, *supra* note 387, at 211 (concluding that Newmont transaction transferred effective control and best rationale for the decision is that the policy expressed in *Revlon* was one against corporate sales which *break up* or dissolve corporations).

419. 542 A.2d 770 (Del. Ch. 1988).

420. No. 9991, 1988 Del. Ch. LEXIS 110 (Del. Ch. Aug. 8, 1988), *reprinted in* 14 DEL. J. CORP. L. 699 (1989).

421. [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,915, at 90,091 (Del. Ch. May 19, 1988), *reprinted in* 14 DEL. J. CORP. L. 273 (1989), *aff'd*, 569 A.2d 53 (Del. 1989).

to doubt that sale of control triggered a *Revlon* duty. Chancellor Allen apparently thought this represented the position of the supreme court when he wrote of "a duty recognized by the Delaware Supreme Court in *Revlon* that arises once it is apparent that a change in control of the corporation is to occur."[422]

The supreme court seemed to want to avoid deciding the *Revlon* trigger issue in *Mills Acquisition*,[423] when it stated: "This case does not require a judicial determination of *when* Macmillan was 'for sale.' *By any standards* this company was for sale both in *Macmillan I* and *II*."[424] Eminent commentators nevertheless construed *Mills Acquisition* as endorsing a sale of control trigger.[425]

It was therefore hardly surprising that, in *Time*, Chancellor Allen invoked a change in control criterion in finding that *Revlon* had not been triggered.[426] Allen's concern with the legitimacy of corporate law is evident in his connecting the focus on change in control with a traditional concern of corporate law, the protection of minority shareholders.

> The existence of a control block of stock in the hands of a single shareholder or a group with loyalty to each other does have real consequences to the financial value of "minority" stock. The law offers some protection to such shares through the imposition of a fiduciary duty upon controlling shareholders.[427]

The supreme court accepted Allen's finding that the Time/Warner transaction did not trigger *Revlon*. However, the court stated that "we premise our rejection of plaintiffs' *Revlon* claim on *different* grounds, namely, the absence of any substantial evidence to conclude that Time's Board, in negotiating with Warner, made the dissolution

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422. *J.P. Stevens*, 542 A.2d at 781.

423. Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1988).

424. *Id.* at 1285 (footnote omitted) (second emphasis added).

425. *See, e.g.*, *What Triggers* Revlon?, *supra* note 8, at 43 ("*Macmillan* clearly holds that *Revlon* is triggered when a recapitalization imposes a change in control.").

426. *Time*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,279-80, *reprinted in* 15 DEL. J. CORP. L. at 738-39.

427. *Id.* at 93,280, *reprinted in* 15 DEL. J. CORP. L. at 739. Gilson and Kraakman echo this connection between the change of control criterion and more general concerns of corporate law when they state that "[t]he primary advantage of a control block test is its direct focus on entrenchment—the very point of the *Revlon* standard." *What Triggers* Revlon?, *supra* note 8, at 52.

or break-up of the corporate entity inevitable, as was the case in *Revlon*."[428]

The manner in which the supreme court rejected the change in control criterion shows that it lacks any settled, considered view of what triggers *Revlon*. This is evident from a crucial difference between its slip opinion, issued on February 26, 1990, seven months after it issued its oral ruling, and its revised opinion of March 9, 1990. While the slip opinion said the court premised its rejection of plaintiffs' *Revlon* argument on "broader" grounds than those Allen had advanced,[429] the revised opinion states that the rejection is based on "different" grounds than Allen's.[430]

This is an important difference. If the court's criterion is "broader" than Allen's, then it also embraces Allen's view that a change in control triggers *Revlon*. However, if the criterion is "different" than Allen's, it is not necessarily the case that a change in control triggers *Revlon*. Whatever the explanation for the change between the initial slip opinion and the revised opinion, that the supreme court could have altered its position on this crucial issue in the space of less than a month is remarkable.

The criterion which the supreme court applied provides less guidance as to when *Revlon* duties are triggered than does the sale of control criterion and thus jeopardizes the relative certainty that the use of that criterion provides. The court had already used the seemingly talismanic words, "the break-up of the company [must be] inevitable," four years before in *Revlon*.[431] If the court was determined to reject the change of control criterion, it should have more thoroughly explained what it intended to be required to trigger *Revlon* duties under the "break-up" criterion.

Many questions arise in applying the "break-up" criterion.[432] An article published in a leading journal prior to the court's decision

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428. *Time*, 571 A.2d at 1150 (emphasis added).

429. Paramount Communications, Inc. v. Time Inc., [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,938, at 95,200, 95,207-11 (Del. Feb. 26, 1990).

430. *Time*, 571 A.2d at 1150.

431. *Revlon*, 506 A.2d at 182.

432. For example, when is the break-up of a company "inevitable"? Is it necessary (and perhaps sufficient) that the purchaser's financing arrangements explicitly require the sale of certain of the target's assets? Or is it sufficient (and perhaps necessary) that the financing arrangements in fact contemplate the sale of the target's assets? Perhaps the inevitability of the company's "break-up" has

had suggested that courts may have misconstrued *Revlon* as a "sale of control" case precisely because of the difficulties in applying a "break-up" test.[433] The difficulty stems in part from the fact that the phrase "break-up of a company" had not previously been used as a legal term. Consequently, there is very little precedent as to what counts as the "break-up of a company." This contrasts with "sale of control," which is a legal concept occurring frequently in corporate law.

In view of the widespread discussion of the *Revlon* trigger in both cases and legal literature, the supreme court should have offered some explanation as to why it rejected the "change in control" criterion, with its relative certainty of interpretation, in favor of the "break-up" criterion. By failing to offer an explanation for its decision, the court missed an opportunity to show how its "inevitability of break-up" criterion connected with other central concerns of corporate law, and to offer guidance to courts and corporate planners in construing the criterion.[434]

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nothing to do with terms in the financing arrangements.

The "break-up" criterion is especially problematic when applied to the conglomerates that were so often the focus of takeover activity in the mid-1980s. *See, e.g.*, Coffee, *supra* note 319, at 77. Suppose an acquiror of a conglomerate involved in three unrelated businesses intended to sell off two of the lines of business but make acquisitions that would supplement the third line. Would such a acquisition involve the "inevitable break-up of the company"?

The Delaware Supreme Court treats MacAndrews and Forbes' acquisition of Revlon as the quintessential case in which "the break-up of the company was inevitable." But even that case raises questions. A year after the acquisition, Revlon *purchased* Max Factor, as well as the Almay and Halston cosmetic business, for about $292 million. In 1989, it further purchased the Betrix family's beauty products and fragrances businesses for a reported $178 million. When Revlon sold these product lines to Proctor & Gamble Company in 1991, analysts were still speaking of the original Revlon as remaining "intact." Anthony Ramirez, *P. & G. Gets Revlon's Max Factor*, N.Y. TIMES, Apr. 11, 1991, at D1, D5. Was Revlon "broken up"? The supreme court's statements provide little help in answering this question.

433. Reder, *supra* note 408, at 281. Reder suggests that courts may have "misconstrued" *Revlon* as being a "change in control" case "because they fear the line-drawing task inherent in interpreting 'breakup' in the current business environment." *Id.* at 281. *See also id.* at 282 ("Unfortunately, the questions inherent in defining a breakup may make that test merely an academic's delight, leaving courts to fashion a test, using instead the bright lines of 'sale' and 'change of control'."). *Cf.* Policastro, *supra* note 387, at 237 (noting difficulty in determining "at what stage of the game the break up of a company is 'inevitable'").

434. The court could have offered a policy justification. The adoption of a corporate break-up test may reflect the court's intention "to encourage mergers and acquisitions performed with the goal of maintaining and improving companies in the long-run while constraining the consummation of takeovers done purely for

2. What Are the Board's Obligations Under *Revlon*?

Chancellor Allen's post-*Revlon* decisions served to define the paths of interpretation that *Revlon* made available on directors' obligations once *Revlon* has been triggered. In *In re J.P. Stevens & Co.*,[435] he identified two possible interpretations:

> First, *Revlon* can be seen as a case essentially involving a board that, if not disloyal to shareholder interests, was in a conflict situation. This divided loyalty . . . justified the court, under conventional doctrine, in reviewing the substantive fairness of the various board actions there taken. Alternatively, *Revlon* may be viewed as a case [that] establishes some rules about the kind of agreements that may not be entered during an auction for corporate control (*e.g.*, those that will stop the bidding or will favor one bidder over another) even by a disinterested, fully functioning board or, at the least, will call forth active judicial review of the wisdom or fairness of such contracts.[436]

Allen interpreted *Revlon* as "essentially a breach of loyalty case in which the board was not seen as acting in the good faith pursuit of the shareholders' interests."[437] However, because rejection of the "rules" interpretation was by itself insufficient to determine the proper analysis of a board's obligations under *Revlon*, Allen developed a framework of analysis.[438]

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short-term economic gain." Policastro, *supra* note 387, at 234. *See* Reder, *supra* note 408, at 282 (concluding that *Revlon*'s break-up trigger reflects "an underlying social policy against breakups").

435. 542 A.2d 770 (Del. Ch. 1988).

436. *Id.* at 778-79.

437. *Fort Howard*, No. 9991, 1988 Del. Ch. LEXIS 110, at *41, *reprinted in* 14 DEL. J. CORP. L. at 722.

438. In an earlier case, Freedman v. Restaurant Assocs. Indus., Inc., [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,502, at 97,214 (Del. Ch. Oct. 16, 1987), *reprinted in* 13 DEL. J. CORP. L. 651 (1988), Chancellor Allen noted a crucial ambiguity in *Revlon*. The supreme court had maintained that *Revlon* required the board to maximize immediate shareholder value, but it had also suggested that a lock-up which ended the bidding would be impermissible. Allen noted that a bidding-ending lock-up might well be the best way to maximize immediate shareholder value; he observed: "Of course, even when designed to promote another bid, a good (i.e., effective) lock-up agreement may well end the bidding after that one last bid it induces is on the table. Thus, the implications of the distinction that *Revlon* draws have yet to be fully worked out." *Id.* at 97,219 n.3, *reprinted in* 13 DEL. J. CORP. L. at 661 n.3. If the *Revlon* obligation is to maximize shareholder value, then it cannot be the case that only those lock-ups that draw new bidders into the bidding, and do not end the bidding, are permissible.

Allen's initial inquiry is whether the transaction, including any advantage given to one bidder, involves either self-dealing[439] or a corporate measure designed to defeat a threatened change in control.[440] If he finds that the transaction involves neither, then Allen does not believe that he is authorized "by *Unocal* or any other precedent of this court or the Supreme Court"[441] to pass upon the substantive merits of the transaction "*except in one respect.*"[442] That "one respect" concerns the board's good faith, in the sense of testing the outer limits of the reasonableness of its decision.[443] Under the rubric of an inquiry into the board's "good faith," Chancellor Allen applied a standard akin to *Unocal*'s "enhanced scrutiny" in a variety of contexts in which directors were required to exercise their *Revlon* duties.[444]

Application of the business judgment rule also requires that the board act with due care.[445] While due care requirements vary with

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439. In such cases, *Weinberger*'s "entire fairness" standard applies. *Weinberger*, 457 A.2d at 710-11.

440. In which case, *Unocal* applies. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

441. *J.P. Stevens*, 542 A.2d at 780.

442. *Id.* (emphasis added).

443. *Id.* at 780-81 (stating that "a court may . . . review the substance of a business decision made by an *apparently* well motivated board for the limited purpose of assessing whether that decision is so far beyond the bounds of reasonable judgment that it seems essentially inexplicable on any ground other than bad faith"). *See also Citron*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,915, at 90,102, *reprinted in* 14 DEL. J. CORP. L. at 301.

> There may be instances in which an apparently disinterested board makes a judgment that is essentially inexplicable except on the basis of an otherwise unproven inappropriate motive—such as personal favoritism or antipathy. . . .
>
> A decision made by competent directors that is not explicable on any rational ground, inevitably does raise a question of the *bona fides* of the decision makers.

Id.

444. *See, e.g.*, *J.P. Stevens*, 542 A.2d at 782-83 (engaging in an extensive analysis of benefits obtained by a board's action, as compared to its costs, in deciding that the action did not constitute bad faith); *Citron*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,915, at 90,103-04, *reprinted in* 14 DEL. J. CORP. L. at 303-05 (engaging in "enhanced" review of two proposals to determine a board's good faith in deciding between the two); *Fort Howard*, No. 9991, 1988 Del. Ch. LEXIS 110, at *40-46, *reprinted in* 14 DEL. J. CORP. L. at 722-24 (holding that the discussion of a board's good faith in giving an advantage to one bidder encompassed an "enhanced" discussion of the benefits the shareholders achieved by the board's following this method as opposed to the method's potential costs).

445. *J.P. Stevens*, 542 A.2d at 780. Allen's decisions on the directors' duties

the circumstances,[446] Allen's decisions in *In re Fort Howard Corp. Shareholders Litigation*,[447] *Roberts v. General Instrument Corp.*,[448] and *Freedman v. Restaurant Associates Industries, Inc.*,[449] make clear that a corporation in a *Revlon* mode need not conduct an auction prior to entering into a merger agreement. *Revlon* does, however, require "at the least that directors take reasonable steps designed to assure that they have probed for alternatives and have a reasonable basis to conclude that the choice that they make is the best available alternative."[450]

Under Allen's view that a board is entitled to the protection of the business judgment rule if it acts in good faith and with due care, it follows that directors cannot be criticized solely for failing to obtain the highest available price. It is

> certainly incorrect to assert that [*Revlon*] recognized a duty on the part of directors when a corporation is "for sale," to get the highest available price. Rather, the duty can only be to try in good faith, in such a setting, to get the best available transaction for the shareholders. *Directors are not insurers*.[451]

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under *Revlon* are notable for their length. As even Allen himself states: "This too lengthy opinion reflects decision on the merits of a stockholder class action that was tried for ten days last spring." *Citron*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,915, at 90,092, *reprinted in* 14 DEL. J. CORP. L. at 278. The length of the opinions is attributable to Allen's insistence that the board act in good faith and with due care. As he says later in *Citron*, with reference to the claim that the board had acted without due care, "[t]he detailed statement of facts recited above is, to my mind, completely inconsistent with a finding of gross negligence. The decision made was made pursuant to a highly deliberate process." *Id.* at 90,103, *reprinted in* 14 DEL. J. CORP. L. at 303.

446. *Interco*, 551 A.2d at 802-03.

447. No. 9991, 1988 Del. Ch. LEXIS 110 (Del. Ch. Aug. 8, 1988), *reprinted in* 14 DEL. J. CORP. L. 699 (1989).

448. [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,465, at 97,399 (Del. Ch. Aug. 13, 1990), *reprinted in* 16 DEL. J. CORP. L. 1540 (1991).

449. [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,617, at 97,882 (Del. Ch. Sept. 19, 1990) (revised Sept. 21, 1990), *reprinted in* 16 DEL. J. CORP. L. 1462 (1991).

450. Braunschweiger v. American Home Shield Corp., [1989-1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,779, at 94,187, 94,192 (Del. Ch. Oct. 26, 1989), *reprinted in* 15 DEL. J. CORP. L. 997, 1009 (1990).

451. *Citron*, Fed. Sec. L. Rep. (CCH) ¶ 93,915, at 90,102-03 n.17, *reprinted in* 14 DEL. J. CORP. L. at 301 n.17 (emphasis added). Thus, "[e]ven when the corporation is clearly 'for sale,' a disinterested board or committee maintains the right and the obligation to exercise business judgment in pursuing the stockholders'

In *Mills Acquisition Co. v. Macmillan, Inc.*,[452] the supreme court attempted to clarify a board's obligations under *Revlon*. The court focused on the difference between its analysis of when the business judgment rule is applied and that of the chancery court. The court, less harshly but no less decisively than in *Time*, repudiated Chancellor Allen's view that, in the absence of self-dealing or a defensive response, a board that has met the requirements of good faith and due care is entitled to the protections of the business judgment rule.[453] It stated:

> It is not altogether clear that, since our decision in *Revlon*, the [c]ourt of [c]hancery has *explicitly* applied the enhanced *Unocal* standards in reviewing such board actions. [The court then cites four chancery court opinions, three of them authored by Chancellor Allen.] On the surface, it may appear that the trial court has been applying an ordinary business judgment rule analysis. However, on closer scrutiny, it seems that there has been a *de facto* application of the *enhanced* business judgment rule under *Unocal*. To the extent that this has caused confusion, we think it is more a matter of semantics than of substance.[454]

The court is correct that its disagreement with Allen is "more a matter of semantics than of substance"; for we saw above that, under the rubric of an inquiry into the board's good faith, Allen engaged in an "enhanced" form of review. It remains an open question whether this difference in formulation matters. The difference may

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interest." *Interco*, 551 A.2d at 802. *See also RJR Nabisco*, Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,700, *reprinted in* 14 DEL. J. CORP. L. at 1168.

> [T]he board of directors continues, in the auction setting as in others, to bear the burden imposed and exercise the power conferred by Section 141(a). Assuming it does exercise a business judgment, in good faith and advisedly, concerning the management of the auction process, it has, in my opinion, satisfied its duty.

Id.

452. 559 A.2d 1261 (Del. 1988).

453. According to the court's view, a plaintiff challenging a board's action must initially show that the directors of the target company treated one (or more) of the bidders on unequal terms. Once the plaintiff has met this burden, the board must meet the enhanced *Unocal* standard before being entitled to the protections of the business judgment rule. To meet this standard, the board must show that it properly believed that shareholder interests were enhanced and that its actions were reasonable in relation to the advantage sought to be achieved. *Id.* at 1288.

454. *Id.* at 1287-88.

be important, for as Chancellor Allen has reminded us: "[I]n the law, to an extent present in few other human institutions, there may be in the long run as much importance ascribed to the reasoning said to justify action, as there is in the actions themselves."[455]

VII. CONCLUSION

"There are unmistakable signs that we may be on the cusp of a new era [in corporate law]."[456]

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The end of the frenzied takeover activity of the latter half of the 1980s provides an appropriate time for reflection on its significance, and on the issues of the corporate legal theory that it "insistently pressed to the surface . . . ."[457] An overview of Chancellor Allen's work, with an emphasis on the development of his views on the two central themes of this article, certainty and legitimacy, provides a unique and valuable perspective on these issues.

Perhaps as a result of Allen's previous work as a corporate litigator, his perception of the importance of certainty in matters of corporate law was evident early in his tenure as chancellor. The two cases in which certainty is most prominent, *Katz v. Oak Industries, Inc.*[458] and *Speiser v. Baker*,[459] were decided in his first two years as chancellor.

Although from early on there was a concern with legitimacy, it was often latent in opinions in which a concern about certainty was on the surface. In *Speiser*, for example, Allen did not explicitly refer to questions of legitimacy, though a concern with it best explains his result and method of analysis.[460] In subsequent cases, however, the emphasis has been on the way in which concerns about legitimacy

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455. *RJR Nabisco*, Fed. Sec. L. Rep. (CCH) ¶ 94,198, at 91,700, *reprinted in* 14 DEL. J. CORP. L. at 1157.

456. *Struggle for Board Autonomy*, *supra* note 39, at 26.

457. *Competing Conceptions*, *supra* note 13, at 19. Allen states:

> Well, the music that had grown frantic, has now slowed. Many of us feel a sense of some relief as a result. The legal questions raised by the 'deal decade,' however, may not fade so quickly as do some of the reputations for financial genius that the decade also created.

William T. Allen, *Independent Directors in MBO Transactions: Are They Fact or Fantasy?*, 45 BUS. LAW. 2055, 2055 (1990).

458. 508 A.2d 873 (Del. Ch. 1986).

459. 525 A.2d 1001 (Del. Ch. 1987).

460. *See supra* text accompanying notes 97-114.

qualify and limit concerns about certainty, rather than on certainty itself.

Allen's increasing involvement in deciding issues posed by the takeover movement appears to have brought questions of the legitimacy of the corporate system to the forefront of his thought. Questions of legitimacy are explicitly central to his decisions in *City Capital Associates v. Interco Inc.*[461] and *Blasius Industries, Inc. v. Atlas Corp.*[462] In *Interco*, Allen's concerns about the threat to legitimacy posed by directors who use pure control devices indefinitely to preclude shareholders from accepting a tender offer, led him to invalidate the directors' continued use of the poison pill. In *Blasius*, Allen gave a ringing and bold endorsement to the role of shareholder voting in legitimating the board of directors' exercise of authority over property they do not own. These two cases are the culmination and high point of an initial phase of Allen's thinking on questions of corporate law, and represent his most significant achievement thus far.

The period since *Interco* and *Blasius* appears to represent a new phase in Allen's thinking; its interpretation is more problematic and its significance is less clear. In the takeover area, Allen registered his doubts about the premises underlying decisions such as *Interco* in *TW Services*, while in *Time* he emphasized the broad scope of the directors' authority to take actions that limit shareholder choice. In the shareholder voting area, Allen's post-*Blasius* decisions are characterized by a narrow and unsatisfying formalism. They fail to implement *Blasius*' rousing proclamations about the legitimating role of shareholder voting and instead suggest a broadening of board authority to take actions affecting shareholder voting.

Part of the explanation for this shift may lie in the dynamics of the relationship between the chancery court and the Delaware Supreme Court. Allen makes a good faith effort to follow the precedents of the supreme court, even when he disagrees.[463] However, he is also acutely aware of how the supreme court will likely respond to some of his opinions, most notably his decision in *Interco*.[464] The shift in Allen's views on the scope of board authority to take actions

461. 551 A.2d 787 (Del. Ch. 1988).

462. 564 A.2d 651 (Del. Ch. 1988).

463. *See, e.g.*, *Roberts*, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,465, at 97,404, *reprinted in* 16 DEL. J. CORP. L. at 1554 (noting that Delaware Supreme Court had "pointedly instructed" the chancery court on the proper standard to be applied in corporate control transactions, and applying that standard).

464. *See supra* text accompanying note 364.

that preclude shareholder choice adumbrated in *TW Services, Inc. v. SWT Acquisition Corp.*[465] and realized in *Paramount Communications, Inc. v. Time, Inc.*[466] may thus reflect a realistic assessment of how the supreme court was likely to respond to opinions that continued in the *Interco* vein. Moreover, even though the Delaware Supreme Court has not, in a published opinion, commented adversely on *Blasius*, it may have made its disapproval of the limits that case placed on the board's authority apparent to Allen in other ways, e.g., in its endorsement of broad directorial power in *Time*. But the dynamics of the relationship between the chancery and the supreme court are surely not the whole of the explanation. Two other factors are important.

First, Allen's post-1988 opinions suggest that even in his most striking opinions, *Interco* and *Blasius*, Allen did not intend radically to alter Delaware corporate law. Particularly to those who are theoretically inclined, the most noteworthy feature of *Interco* and *Blasius* is their broad and general language. That language was thought to contain the seeds of a radical transformation of Delaware law favoring an expansion of shareholder rights, while restricting a board's authority to act in ways which preclude shareholder choice. Allen's subsequent opinions in these areas suggest that his goals are more modest. From this perspective, the actual *results* in even the most apparently radical cases are more important than their striking general language. In *Interco*, Allen restricted the board's authority indefinitely to keep a poison pill in place; but he also upheld (and broadly endorsed) the target board's authority to continue to manage the corporation, even if doing so were to make it substantially less likely that the shareholders would be able to accept a hostile tender offer. In *Blasius*, Allen invalidated the target board's action where it had explicitly interfered with a voting procedure expressly authorized by Delaware statutory law. Even if its highly theoretical statements about the legitimating role of shareholder voting could be construed to portend an expansive interpretation of shareholder voting rights, the decision on the actual facts is also consistent with the narrow and formalistic results Allen has reached in subsequent cases.

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465. [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,173 (Del. Ch. Mar. 2, 1989), *reprinted in* 14 DEL. J. CORP. L. 1169 (1989).

466. [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,264 (Del. Ch. July 14, 1989) (revised July 17, 1989), *reprinted in* 15 DEL. J. CORP. L. 700 (1990).

This perspective on Chancellor Allen's intentions does not diminish his significance. Rather, it suggests an interesting and complex tension in his judicial product. He is particularly aware of the theoretical underpinnings of even technical questions in corporate law and of the broader questions of legitimacy that such questions pose. Some of his most important decisions display a strong interest in such theoretical issues. However, he is not principally a theoretician, one whose method is to state a general principle and then develop its implications in a rigorously logical fashion. As a jurist in a court of equity, he is highly attentive to the facts of each case. Of course, this does not mean that Allen's broad general statements in cases such as *Interco* and *Blasius* are unimportant, but it does mean that they should not be overinterpreted; for it is the facts of the case in relation to the principle, not the principle itself, that drives the decision.

Second, Allen's views on certain critical assumptions concerning the conditions under which corporate authority is legitimately exercised, which underlay his previous claims in *Interco* and *Blasius*, appear to be in the process of developing. A particular conception of the nature of the corporation implicitly underlies *Interco*. According to that conception, which Allen calls the "property" model, the corporation's property is equitably the property of the shareholders, and "it is unquestionably on *their* behalf that the directors are bound to act."[467] In the period since *Interco*, Allen has come to believe that an exclusive focus on the property model neglects the existence of other conceptions, such as what he calls the "social entity conception."[468] According to this conception, a corporation and its board of directors are "seen as owing duties to various groups or constituencies affected by the corporation's operation. . . ."[469] Recognition of the social entity conception has paralleled, and to an extent been prompted by, the proliferation of "constituency statutes," which generally authorize directors to consider "not just what is in shareholder best interests but to consider the impact on other groups affected by corporate action including employees, customers, creditors, suppliers and communities in which the corporation has facilities."[470]

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467. *Competing Conceptions*, *supra* note 13, at 13.
468. *Id.* at 9.
469. *Id.* at 9-10.
470. *Id.* at 21.

While Allen's post-*Interco* opinions and addresses reflect an attraction to the idea that corporate directors may properly take into account non-shareholder interests, he has not endorsed that conception, nor has he repudiated the property model that underlies *Interco*. A crucial question is whether the various conceptions can show the directors' exercise of authority to be legitimate. As we have seen, Chancellor Allen is concerned that the actions of a board that is responsible to "everyone" may lack legitimacy.[471] While Allen has not yet provided his answer to these deep questions, his work has focused attention on the question of the proper conception of the corporation as one of the key issues for corporate law in the 1990s.

Blasius is remarkable for Allen's insistence that shareholder voting plays a central legitimating role, whether or not shareholders are in a position to hold directors accountable. He has since come to doubt that claim; two years later expressing the view that "in practically all situations involving public companies the shareholder vote supplies a tenable but not compelling basis for legitimation and, no accountability."[472] Allen has not, however, abandoned the search for some institutional mechanism that will be able to hold directors accountable, and thus provide a more compelling basis for the legitimacy of directors' actions.

Allen believes that the rise of institutional investors "may bring some reality to the shareholder voting process, which [has] come to be seen as an empty formality,"[473] and he is cautiously optimistic that they will provide a means of rendering directors accountable. One cannot simply assume that institutional investors will play the same role in ensuring accountability that was played by traditional owners whose property was managed by agents. Unlike traditional owners, institutional investors are fully diversified investors whose interest is in "any stock in a certain sector or industry, with a certain projected cash flow and a given beta coefficient."[474] Moreover, since institutional investors are not human beings, their incentive structures differ from those of human owners. Hence, Allen believes that "the question of compensation systems within such institutions will become increasingly important generally . . . ."[475]

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471. *See supra* text accompanying notes 370-82.

472. *Competing Conceptions*, *supra* note 13, at 25.

473. *Id.* at 25. Other commentators have noted the significance of the increase in institutional investors. *See, e.g.*, Gilson & Kraakman, *supra* note 40.

474. *Struggle for Board Autonomy*, *supra* note 39, at 28.

475. *Id.* at 29.

Allen also believes that it would be a mistake to assume that institutional investors will inevitably come to control corporate management. They may not want to do so. More importantly, they may not be able to do so. The powerful forces that prompted the adoption of constituency statutes

> cannot be expected passively to accept control of modern business corporations by institutional investors through voting of stock, if that control threatens [costs similar to those associated with corporate takeovers]. Resistance will occur in courts, in the press and in legislative halls. The attack will be on the right to vote stock.[476]

Chancellor Allen has not yet come to any firm conclusions about the role of institutional investors in providing accountability, and thus ensuring the legitimacy of corporate law. But, as in the case of his reflections about the proper conception of the corporation, he has focused attention on the right questions and endeavored to answer them in a candid, informed way. This approach may, in the final analysis, do more to legitimate corporate law than could any particular theory of corporate law.

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476. *Id.* at 30-31.