CHANCELLOR ALLEN, THE BUSINESS JUDGMENT RULE, AND THE SHAREHOLDERS' RIGHT TO DECIDE

By Dennis J. Block, Stephen A. Radin, and Michael J. Maimone*

"We have now just concluded a decade in which unprecedented merger and acquisition activity raised issues of corporation law that had lain dormant for fifty years."[1] Many lawyers, academics, and jurists have "struggle[d] to fashion answers" to the myriad of business judgment rule questions raised during the "deal decade"[2] of the 1980s and the new issues that have arisen in the 1990s, but none has surpassed the intellectual ability and skill consistently demonstrated by Chancellor William T. Allen of the Delaware Court of Chancery in resolving these difficult issues. Chancellor Allen's achievements are all the more noteworthy in light of the extraordinary quality of the court of chancery and the substantial accomplishments of Chancellor Allen's distinguished predecessors (most recently, Chancellors William Marvel and Grover C. Brown), and Chancellor Allen's current colleagues on the court of chancery (Vice-Chancellors Maurice A. Hartnett, III, Carolyn Berger, Jack B. Jacobs, and William B. Chandler, III).

Since joining the Delaware Court of Chancery in 1985, Chancellor Allen has authored over twenty decisions addressing the relationship (and tension) between the right and duty of corporate directors to manage the business and affairs of corporations and the right of shareholders to tender or vote their stock as they see fit during a contest for corporate control. These decisions are noteworthy not only because of the many aspects of business judgment rule jurisprudence the chancellor addresses, but also because of the speed with which these decisions have been drafted due to time pressures imposed by litigants demanding preliminary injunctive relief or temporary restraining orders.[3]

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* Dennis J. Block and Stephen A. Radin are members of the firm Weil, Gotshal & Manges in New York City. Michael J. Maimone is an associate at Weil, Gotshal & Manges. Portions of this article are derived from Dennis J. Block, Nancy E. Barton & Stephen A. Radin, *The Business Judgment Rule: Fiduciary Duties of Corporate Directors* (3d ed. 1989 & Supp. 1991).

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

2. *Id.*

3. Significant corporate law decisions discussed in this article that were authored

This article explores a collection of Chancellor Allen's corporate governance decisions.[4] Section I outlines the Delaware Supreme Court's

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by Chancellor Allen within a week of oral argument include: Sutton Holding Corp. v. Desoto, Inc., [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,012, at 90,063 (Del. Ch. May 14, 1991), *reprinted in* 17 DEL. J. CORP. L. 363 (1992) (opinion drafted in one day); Lennane v. Ask Computer Sys., Inc., [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,674, at 98,149 (Del. Ch. Oct. 11, 1990), *reprinted in* 16 DEL. J. CORP. L. 1521 (1991), *modified on reargument*, No. 11,744, 1990 Del. Ch. LEXIS 168 (Del. Ch. Oct. 11, 1990) (Reconsideration: Oct. 19, 1990), *reprinted in* 16 DEL. J. CORP. L. 1538 (1991) (opinion drafted in two days); Roberts v. General Instrument Corp., [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) (opinion drafted in four days); Stahl v. Apple Bancorp, Inc., 579 A.2d 1115 (Del. Ch. 1990) (*Stahl I*) (opinion drafted in three days), *subsequent proceedings*, Stahl v. Apple Bancorp, Inc., [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,412, at 97,031 (Del. Ch. Aug. 9, 1990) (*Stahl II*), *reprinted in* 16 DEL. J. CORP. L. 1573 (1991) (opinion drafted in three days); Gintel v. XTRA Corp., No. 11,422 (Del. Ch. Feb. 27, 1990) (oral ruling immediately following oral argument); 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) (opinion drafted in three days), *aff'd*, 571 A.2d 1140 (Del. 1990); *In re* RJR Nabisco, Inc. Shareholders Litig., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,700 (Del. Ch. Jan. 31, 1989), *reprinted in* 14 DEL. J. CORP. L. 1132 (1989) (opinion drafted in six days); Citron v. Steego Corp., No. 10,171, 1988 Del. Ch. LEXIS 119 (Del. Ch. Sept. 9, 1988), *reprinted in* 14 DEL. J. CORP. L. 634 (1989) (opinion drafted in one day); *In re* Fort Howard Corp. Shareholders Litig., No. 9991 (Consolidated), 1988 Del. Ch. LEXIS 110 (Del. Ch. Aug. 8, 1988), *reprinted in* 14 DEL. J. CORP. L. 699 (1989) (opinion drafted in four days); *In re* J.P. Stevens & Co. Shareholders Litig., 542 A.2d 770 (Del. Ch. 1988) (opinion drafted in two days); Solash v. Telex Corp., [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608, at 97,722 (Del. Ch. Jan. 19, 1988), *reprinted in* 13 DEL. J. CORP. L. 1250 (1988) (opinion drafted in five days); 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) (opinion drafted in one day); and AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986) (opinion drafted in three days). Unless noted otherwise, Chancellor Allen wrote all court of chancery decisions cited in this article.

4. This article does not purport to address all of Chancellor Allen's corporate governance decisions, but focuses only on decisions articulating the business judgment rule and discussing its application in the context of corporate control transactions. One particularly noteworthy application of the business judgment rule that Chancellor Allen has addressed in several significant decisions but that is not addressed in this article is shareholder derivative litigation, including the pre-litigation demand requirement and the termination of derivative litigation by disinterested directors. *See, e.g.*, Kahn v. Tremont Corp., No. 12,339, 1992 Del. Ch. LEXIS 165 (Del. Ch. Aug. 21, 1992); Abajian v. Kennedy, No. 11,425, 1992 Del. Ch. LEXIS 6 (Del. Ch. Jan. 17, 1992); Thorpe v. Cerbco, Inc., [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,416, at 91,769 (Del. Ch. Nov. 15, 1991), *reprinted in* 17 DEL. J. CORP. L. 1284 (1992); Avacus Partners v. Brian, No. 11,001, 1990 Del.

articulation of three forms of judicial review governing shareholder challenges to board decisions: the business judgment rule, which governs most board conduct;[5] the *Unocal Corp. v. Mesa Petroleum Co.*[6] modification of the business judgment rule, which governs board conduct involving defensive measures adopted by directors in order to protect the corporation from unsolicited takeovers;[7] and the fairness standard, which governs board conduct not subject to the business judgment rule or the *Unocal* variation of the rule.[8] Section I then outlines Chancellor Allen's contributions to the Delaware Court of Chancery's effort to apply the general principles established by the Delaware Supreme Court in business judgment rule cases. This includes the Chancellor's exploration of three distinct elements of the business judgment rule—disinterestedness and independence, good faith, and due care—[9] and the Chancellor's recognition of the "powerful"[10] and "enormous"[11] consequences of employing the business judgment rule rather than the fairness form of judicial review.[12]

Section II of this article explores a series of decisions by Chancellor Allen in cases involving contests for corporate control and corporate auctions,[13] including *Paramount Communications, Inc. v. Time, Inc.*,[14] *In re RJR Nabisco, Inc. Shareholders Litigation*,[15] *In re J.P. Stevens & Co.*

Ch. LEXIS 178 (Del. Ch. Oct. 24, 1990), *reprinted in* 16 DEL. J. CORP. L. 1425 (1991); Heineman v. Datapoint Corp., [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,664, at 98,113 (Del. Ch. Oct. 9, 1990), *reprinted in* 16 DEL. J. CORP. L. 1508 (1991); Harris v. Carter, 582 A.2d 222 (Del. Ch. 1990); Spiegel v. Buntrock, No. 8936, 1988 Del. Ch. LEXIS 149 (Del. Ch. Nov. 17, 1988), *reargument denied*, No. 8936, 1988 Del. Ch. LEXIS 160 (Del. Ch. Dec. 14, 1988), *aff'd*, 571 A.2d 767 (Del. 1990).

5. *See infra* notes 29-35 and accompanying text.

6. 493 A.2d 946 (Del. 1985).

7. *See infra* notes 36-44 and accompanying text.

8. *See infra* notes 45-47 and accompanying text.

9. *See infra* notes 48-82 and accompanying text.

10. Solash v. Telex Corp., [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608, at 97,727 (Del. Ch. Jan. 19, 1988), *reprinted in* 13 DEL. J. CORP. L. 1250, 1263 (1988); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986).

11. Cinerama, Inc. v. Technicolor, Inc., No. 8358, 1991 Del. Ch. LEXIS 105, at *36 (Del. Ch. June 21, 1991) (Revised June 24, 1991), *reprinted in* 17 DEL. J. CORP. L. 551, 572 (1992).

12. *See infra* notes 83-98 and accompanying text.

13. *See infra* notes 99-228 and accompanying text.

14. [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), *aff'd*, 571 A.2d 1140 (Del. 1990).

15. [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,700 (Del. Ch. Jan. 31, 1989), *reprinted in* 14 DEL. J. CORP. L. 1132 (1989).

Shareholders Litigation,[16] *In re Fort Howard Corp. Shareholders Litigation*,[17] and *Roberts v. General Instruments Corp.*[18] Section II also explores cases involving cash-out merger transactions pursuant to which minority shareholders are forced by a controlling shareholder to give up their equity in a corporation in exchange for cash or securities.[19] The decisions discussed in Section II provide important examples of Chancellor Allen's views regarding the deference to be accorded under appropriate circumstances to business judgments made by disinterested and independent directors acting in good faith and on an informed basis, and illustrate Chancellor Allen's recognition that Delaware "corporation law has long assumed that disinterested directors *can* exercise a business judgment unaffected by the fact that the CEO of the firm[, for example,] may be self-interested."[20]

Finally, Section III of this article focuses upon three cases in which Chancellor Allen has enjoined conduct involving the deprivation of shareholder rights by boards where directors have *not* been found by the chancellor to have been interested or to have acted in bad faith or without due care: *AC Acquisitions Corp. v. Anderson, Clayton & Co.*,[21] *City Capital Associates v. Interco, Inc.*,[22] and *Blasius Industries, Inc. v. Atlas Corp.*[23] *Anderson, Clayton* and *Interco* deal with board conduct that effectively blocks shareholders from determining for themselves whether they wish to tender their shares to a potential acquiror opposed by an incumbent board. These decisions, which contain language that is arguably inconsistent with the Delaware Supreme Court's subsequent decision in *Paramount Communications, Inc. v. Time Inc.*,[24] do not address board decisions to use a poison pill shareholder rights plan to "just say no" to an all cash for all shares offer posing no threat to the corporation other than price inadequacy, under circumstances where no auction or alternative value-maximizing transaction has been or will be proposed.[25] *Blasius* deals with board conduct that effectively

16. 542 A.2d 770 (Del. Ch. 1988).

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

18. [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).

19. *See infra* notes 229-48 and accompanying text.

20. Allen, *supra* note 1, at 2057.

21. 519 A.2d 103 (Del. Ch. 1986).

22. 551 A.2d 787 (Del. Ch.), *appeal dismissed*, 556 A.2d 1070 (Del. 1988).

23. 564 A.2d 651 (Del. Ch. 1988).

24. 571 A.2d 1140 (Del. 1990).

25. *See infra* notes 249-312 and accompanying text.

blocks shareholders from determining for themselves whether they wish to vote an incumbent board out of office. *Blasius* has been read narrowly by Chancellor Allen in several later opinions, and while the Delaware Supreme Court has recently stated that "we accept the basic legal tenets"[26] of *Blasius*, the ultimate reach of *Blasius* is certain to be the subject of more litigation in years to come.[27]

I. THE BUSINESS JUDGMENT RULE

Under well-established Delaware Supreme Court authority, one of three levels of judicial review governs litigation in which shareholders challenge the conduct of directors: the traditional business judgment rule standard of review, the *Unocal* standard of review, or the fairness standard of review. The following discussion outlines Delaware Supreme Court authority establishing these three levels of judicial review, and then turns to Chancellor Allen's contributions to the Delaware Court of Chancery's effort to apply these general principles.

A. The Supreme Court Framework

1. The Traditional Business Judgment Rule

Sixteen Delaware Supreme Court decisions since 1984 address the business judgment rule,[28] which is typically the governing standard in cases challenging board conduct. The business judgment rule creates "a presumption that in making a business decision, not involving self-interest, the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[29] The party challenging the board's

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26. Stroud v. Grace, 606 A.2d 75, 91 (Del. 1992).

27. *See infra* notes 313-75 and accompanying text.

28. *See infra* note 29 (citing the 16 Delaware Supreme Court cases addressing the business judgment rule since 1984).

29. Levine v. Smith, 591 A.2d 194, 207 (Del. 1991) (citations omitted); *see also* Stroud v. Grace, 606 A.2d 75, 83 (Del. 1992); Kahn v. Sullivan, 594 A.2d 48, 59 (Del. 1991); Gilbert v. El Paso Co., 575 A.2d 1131, 1145, 1147 (Del. 1990); Spiegel v. Buntrock, 571 A.2d 767, 774 (Del. 1990); *In re* Resorts Int'l Shareholders Litig., 570 A.2d 259, 267 (Del. 1990); Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 64 (Del. 1989); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279, 1288 (Del. 1989); Grobow v. Perot, 539 A.2d 180, 187 (Del. 1988); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1341 (Del. 1987); Polk v. Good, 507 A.2d 531, 536 (Del. 1986); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1356 (Del. 1985); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985); Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

decision has the burden of establishing facts overcoming this presumption.[30] The standard for determining whether a business decision has been made on an informed basis is "gross negligence."[31]

According to Chancellor Allen, the business judgment rule "reflects the fact that ours is an economic order in which investment choices and implementing business decisions are chiefly made by private persons, not by government functionaries or judges. . . . [I]n our social order courts are . . . not thought to be very good institutionally at making such judgments."[32] As Chancellor Allen wrote in *Solash v. Telex Corp.*[33] and *In re J.P. Stevens & Co. Shareholders Litigation*[34]:

> Because businessmen and women are correctly perceived as possessing skills, information and judgment not possessed by reviewing courts and because there is great social utility in encouraging the allocation of assets and the evaluation and assumption of economic risk by those with such skill and information, courts have long been reluctant to second-guess such decisions when they appear to have been made in good faith.[35]

2. *Unocal*

The Delaware Supreme Court's landmark 1985 decision in *Unocal Corp. v. Mesa Petroleum Co.*[36] set forth different rules to govern "any defensive measures taken in response to some threat to corporate policy and effectiveness which touch upon issues of control."[37] The

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30. *Stroud*, 606 A.2d at 83; *Spiegel*, 571 A.2d at 774 (citing *Fairchild*, 569 A.2d at 64; *Aronson*, 473 A.2d at 812).

31. *See Levine*, 591 A.2d at 207; *Resorts*, 570 A.2d at 267; *Fairchild*, 569 A.2d at 66; *Grobow*, 539 A.2d at 190; *Household*, 500 A.2d at 1356; *Van Gorkom*, 488 A.2d at 873; *Aronson*, 473 A.2d at 812.

32. William T. Allen, *Investment Bankers' and Judicial Review of Corporate Action to Defeat Hostile Takeovers: Comments on Chapter 6*, *in* THE BATTLE FOR CORPORATE CONTROL: SHAREHOLDER RIGHTS, STAKEHOLDER INTERESTS, & MANAGERIAL RESPONSIBILITIES 131, 134-35 (Arnold W. Sametz & James L. Bicksler eds. 1991).

33. [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608, at 97,722 (Del. Ch. Jan. 19, 1988), *reprinted in* 13 DEL. J. CORP. L. 1250 (1988).

34. 542 A.2d 770 (Del. Ch. 1988).

35. *Id.* at 780 (quoting Solash v. Telex Corp., [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608, at 97,727 (Del. Ch. Jan. 19, 1988), *reprinted in* 13 DEL. J. CORP. L. 1250, 1262 (1988)).

36. 493 A.2d 946 (Del. 1985).

37. Gilbert v. El Paso Co., 575 A.2d 1131, 1144 (Del. 1990) (citing *Unocal*, 493 A.2d at 955).

supreme court explained in *Unocal* that in the control context the "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders [gives rise to] an enhanced duty"[38] to shareholders that dictates "judicial examination at the threshold before the protections of the business judgment rule may be conferred."[39]

Accordingly, unlike typical business judgment rule cases where the burden of proof is on the party challenging the transaction, the initial burden in cases involving defensive measures lies with the directors, who must demonstrate (1) that they had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed," and (2) that the defensive measure decided upon was "reasonable in relation to the threat posed."[40] A board undertaking this analysis must evaluate "the nature of the takeover bid and its effect on the corporate enterprise."[41] This involves consideration of various factors, including:

> the adequacy and terms of the offer; its fairness and feasibility; the proposed or actual financing for the offer, and the consequences of that financing; questions of illegality; the impact of both the bid and the potential acquisition on other constituencies, provided that it bears some reasonable relationship to general shareholder interests; the risk of non-consummation; the basic stockholder interests at stake; the bidder's identity, prior background and other business venture experiences; and the bidder's business plans for the corporation and their effects on stockholder interests.[42]

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

39. *Id.* The Delaware Supreme Court has reaffirmed the *Unocal* standard in a series of more recent decisions. *See* Stroud v. Grace, 606 A.2d 75, 82 (Del. 1992); *El Paso*, 575 A.2d at 1144; Paramount Communications Inc. v. Time Inc., 571 A.2d 1140, 1154 (Del. 1990); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1287 (Del. 1989); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1341 (Del. 1987); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1350 (Del. 1985).

40. *Unocal*, 493 A.2d at 955; *see also Stroud*, 606 A.2d at 82; *Time*, 571 A.2d at 1152; *Macmillan*, 559 A.2d at 1288; *Newmont*, 535 A.2d at 1341; *Revlon*, 506 A.2d 180; *Household*, 500 A.2d at 1356.

41. *Unocal*, 493 A.2d at 955; *see also Newmont*, 535 A.2d at 1341-42.

42. *Macmillan*, 559 A.2d at 1282 n.29; *see also Time*, 571 A.2d at 1153; *Unocal*, 493 A.2d at 955-56.

The two-pronged *Unocal* "burden" may be satisfied "by showing good faith and reasonable investigation."[43] Once this burden is met, traditional business judgment rule principles apply, and the plaintiff bears the burden of demonstrating a breach of the directors' fiduciary duties.[44]

3. Fairness

The fairness standard, according to the Delaware Supreme Court, governs "only if the presumption of the business judgment rule is defeated."[45] A transaction subject to the fairness standard is scrutinized by the court to determine whether the transaction is fair to the shareholders.[46] This fairness standard is an exacting standard, requiring rigorous judicial scrutiny regarding both "fair dealing" and "fair price."[47]

B. Chancellor Allen and the Business Judgment Rule

Chancellor Allen has made several important contributions to the Delaware Court of Chancery's effort to apply the general principles established by the Delaware Supreme Court's business judgment rule decisions. These contributions include an exploration of three distinct elements or inquiries required in cases involving what Chancellor Allen has labeled the "plain vanilla business judgment rule,"[48] and the chancellor's articulation of the "powerful"[49] and "enormous substantive law, not just procedural, consequences"[50] to employing the business judgment rule standard of review rather than the fairness form of judicial review.

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43. *Unocal*, 493 A.2d at 955; *see also Time*, 571 A.2d at 1152; *Newmont*, 535 A.2d at 1341; *Revlon*, 506 A.2d at 180; *Household*, 500 A.2d at 1356.

44. *Household*, 500 A.2d at 1356 (quoting *Unocal*, 493 A.2d at 958).

45. Grobow v. Perot, 539 A.2d 180, 187 (Del. 1988) (citing Aronson v. Lewis, 473 A.2d 805, 812-17 (Del. 1984)).

46. Smith v. Van Gorkom, 488 A.2d 858, 893 (Del. 1985).

47. *Macmillan*, 559 A.2d at 1280 (citing Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983)).

48. Spiegel v. Buntrock, No. 8936, 1988 Del. Ch. LEXIS 149, at *8 (Del. Ch. Nov. 17, 1988), *reargument denied*, No. 8936, 1988 Del. Ch. LEXIS 160 (Del. Ch. Dec. 14, 1988), *aff'd*, 571 A.2d 767 (Del. 1990).

49. Solash v. Telex Corp., [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608, at 97,722, 97,727 (Del. Ch. Jan. 19, 1988), *reprinted in* 13 DEL. J. CORP. L. 1250, 1263 (1988).

50. Cinerama, Inc. v. Technicolor, Inc., No. 8358, 1991 Del. Ch. LEXIS 105, at *36 (Del. Ch. June 21, 1991) (Revised June 24, 1991), *reprinted in* 17 DEL. J. CORP. L. 551, 572 (1992).

According to Chancellor Allen, the business judgment standard of judicial review encompasses three distinct elements or inquiries: "[1] a threshold review of the objective financial interests of the board whose decision is under attack (*i.e.*, independence), [2] a review of the board's subjective motivation (*i.e.*, good faith), and [3] an objective review of the process by which it reached the decision under review (*i.e.*, due care)."[51] Stated more succinctly, "the business judgment rule provides that a decision made by an independent board will not give rise to liability (nor will it be the proper subject of equitable remedies) if it is made in good faith and in the exercise of due care."[52]

The first element of the business judgment rule, according to Chancellor Allen, "is . . . of course, a condition to the use of the business judgment form of review; if the board is financially interested in the transaction, the appropriate form of judicial review is to place upon the board the burden to establish the entire fairness of the transaction."[53] The second and third elements, according to the Chancellor, reflect:

> one of the two theoretically possible bases for director liability in a disinterested transaction. If each is satisfied (*i.e.*, plaintiff cannot show a *prima facie* case of, or, if such case is made out, the balance of the evidence does not establish, bad faith or gross negligence), then there is . . . no basis to issue an injunction or to impose liability.[54]

1. Disinterestedness and Independence

As noted above, the first element of the business judgment rule standard of judicial review, according to Chancellor Allen, is a "thresh-

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51. *Id.* at *28, *reprinted in* 17 DEL. J. CORP. L. at 568-69 (quoting *In re* RJR Nabisco, Inc. Shareholders Litig., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,700 (Del. Ch. Jan. 31, 1989), *reprinted in* 14 DEL. J. CORP. L. 1132 (1989)).

52. *In re* J.P. Stevens & Co. Shareholders Litig., 542 A.2d 770, 780 (Del. Ch. 1988).

53. *Technicolor*, No. 8358, 1991 Del. Ch. LEXIS 105, at *28, *reprinted in* 17 DEL. J. CORP. L. at 568 (quoting *RJR Nabisco*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,709, *reprinted in* 14 DEL. J. CORP. L. at 1156).

54. *Id.* at *29, *reprinted in* 14 DEL. J. CORP. L. at 1156 (quoting *RJR Nabisco*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,710); *see also* Short v. McNatt, No. 10,077, 1991 Del. Ch. LEXIS 88, at *11, 12 (Del. Ch. May 17, 1991), *reprinted in* 17 DEL. J. CORP. L. 649, 656 (1992) (plaintiff bears burden of "establishing by a preponderance of the evidence" that one of the elements of the business judgment rule is not present).

old" examination of "the objective financial interests of the board whose decision is under attack (*i.e.*, independence)."[55] This threshold examination is required because the deference accorded to board decisions "ends when a transaction is one involving a predominately interested board with a financial interest in the transaction adverse to the corporation."[56] In this context, Chancellor Allen has observed, "there is no alternative to a judicial evaluation of the fairness of the terms of the transaction other than the unacceptable one of leaving shareholders unprotected."[57]

Among Chancellor Allen's contributions to the case law governing the business judgment rule's disinterestedness and independence requirement is his recognition that the disabling interest must be a "material" rather than a "*de minimus*" interest. Thus, for instance, the Chancellor observed in one of his earliest decisions involving director disinterestedness, *Jedwab v. MGM Grand Hotels, Inc.*,[58] that the "*de minimus* value" of a $1.3 million asset in the context of a $440 million transaction "would not appear to create a material conflict"[59] but that a potential $25 million benefit was not *de minimus*, and thus "justif[ied] invocation of the heightened standard of judicial review"[60] that governs cases where plaintiffs have overcome the business judgment rule.

The Chancellor elaborated upon this point in *Cinerama, Inc. v. Technicolor, Inc.*,[61] and defined the term "material" in this context to refer "to a financial interest that in the circumstances create[s] a reasonable probability that the independence of the judgment of a reasonable person in such circumstances could be affected to the detriment of the shareholders generally."[62] The Chancellor emphasized that "[i]n some instances an arguable or an established personal financial benefit may, when viewed in context, be found to be immaterial in fact to the exercise of a judgment motivated entirely to

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55. *Technicolor*, No. 8358, 1991 Del. Ch. LEXIS 105, at *28, *reprinted in* 17 DEL. J. CORP. L. at 568 (quoting *RJR Nabisco*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,709, *reprinted in* 14 DEL. J. CORP. L. at 1156).

56. AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986).

57. *Id.*

58. 509 A.2d 584 (Del. Ch. 1986).

59. *Id.* at 595 n.7.

60. *Id.* at 596.

61. No. 8358, 1991 Del. Ch. LEXIS 105 (Del. Ch. June 21, 1991) (Revised June 24, 1991), *reprinted in* 17 DEL. J. CORP. L. 551 (1992).

62. *Id.* at *37, *reprinted in* 17 DEL. J. CORP. L. at 573.

achieve the best available result for the corporation and (in the sale context) for its shareholders."[63]

Chancellor Allen offered a hypothetical to illustrate this point:

> . . . Consider the case of the sale of a public company which is owned 35% by the CEO and 10% by the company's vice president. The company has a market capitalization of $100 million. The two officers constitute a majority of the board. Each has a salary and benefit package worth approximately $550,000 per year. During arm's-length bargaining an acquisition of the corporation is negotiated with a third party for $160 million cash. As part of the transaction, it is agreed that the two officers will remain as officers of the company at a new higher (say doubled) salary.
>
> Assume now that a shareholder sues the directors claiming that they negligently failed to get the best available price. The directors didn't shop the Company, "locked up" the sale, and had no fiduciary out in the merger agreement. Plaintiff also (implausibly) asserts that the directors pushed this transaction rather than search for a higher alternative that might have been found in order to get the higher salaries that the acquiror proposed. Must the directors assume the burden of establishing the entire fairness of the transaction?[64]

The Chancellor acknowledged that the directors in this hypothetical do have a financial interest in the merger not shared by the other shareholders. The Chancellor concluded, however, that the directors do not have a material interest in the transaction different from the interests of other shareholders. Accordingly, the Chancellor held, the directors' conduct is subject to review pursuant to the business judgment rule, and the directors should not "be required by the imposition of the entire fairness rule to prove that they made no mistake or to be at risk to pay rescissory damages if in good faith they did make mistakes (or were negligent)."[65]

Applying this standard to the facts in the *Technicolor* case, Chancellor Allen rejected allegations that Morton Kamerman, the chairman and chief executive officer of Technicolor, had a material financial interest in an acquisition of Technicolor by MacAndrews & Forbes

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63. *Id.* at *33-34, *reprinted in* 17 DEL. J. CORP. L. at 571.
64. *Id.* at *34-35, *reprinted in* 17 DEL. J. CORP. L. at 571-72.
65. *Id.* at *37, *reprinted in* 17 DEL. J. CORP. L. at 573 (emphasis omitted).

Group, Inc., because Kamerman had negotiated certain amendments to his employment agreement in connection with the acquisition. The Chancellor explained that the amended benefits "were *de minimus* from the buyer's point of view and reasonable in all events."[66] The Chancellor noted that Kamerman was "respected by the board and important to the company" and that it was "unlikely he could not have gotten more generous amendments than these to his employment contract" even in the absence of an acquisition.[67] The Chancellor added that the "modest changes" negotiated by Kamerman "create[d] no financial interest to sell the company once one focuses on what, as a practical matter, was given up by Kamerman in the transaction," and that in any event "it is naive to think that comparable amendments would not have been available from any buyer."[68]

The Chancellor also rejected plaintiff's contention that Kamerman and Guy Bjorkman, a Technicolor director who was a nine percent shareholder of Technicolor, had a material financial interest in the challenged transaction due to the signing of a stock purchase agreement that bound Kamerman and Bjorkman to sell their Technicolor stock to MacAndrews & Forbes for the same $23 cash as other shareholders would receive pursuant to the agreed upon merger transaction, with Kamerman and Bjorkman to receive any higher price that MacAndrews & Forbes ultimately agreed to pay to any other Technicolor shareholder.[69] This provision, the Chancellor explained,

> was prudent from the point of view of the individual sellers (in case a higher offer emerged) and was not in conflict with other shareholders. Indeed, in terms of incentives, it reinforced the incentive to get the highest price for others. . . . This agreement was part of [MacAndrews & Forbes'] effort to "lock-up" the purchase. It was instigated by [MacAndrews & Forbes] and conferred no substantial benefit on Kamerman other than fostering and protecting the $23 cash transaction which for good (as defendant's claim) or ill (as [plaintiff] asserts) was an effect shared by all stockholders.[70]

Finally, the Chancellor held that an agreement that Kamerman would join the MacAndrews & Forbes Board following the MacAndrews &

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66. *Id.* at *43, *reprinted in* 17 DEL. J. CORP. L. at 575.
67. *Id.* at *41-42, *reprinted in* 17 DEL. J. CORP. L. at 574-75.
68. *Id.* at *41-42, *reprinted in* 17 DEL. J. CORP. L. at 575.
69. *Id.* at *43, *reprinted in* 17 DEL. J. CORP. L. at 575-76.
70. *Id.* at *43-44, *reprinted in* 17 DEL. J. CORP. L. at 575.

Forbes acquisition of Technicolor was *de minimus* and, therefore, insufficient to trigger the fairness level of judicial review.[71]

2. Good Faith

The second element of business judgment rule analysis, according to Chancellor Allen, is "a review of the board's subjective motivation (*i.e.*, good faith)."[72] "[T]he absence of significant financial adverse interest creates a presumption of good faith, or a prima facie showing of it," Chancellor Allen has observed, "but the question of *bona fides* may not be finally determined on that basis alone. Rather, the question calls for an *ad hoc* determination of the board's motives" in making a business decision which is later challenged.[73]

The business judgment rule, according to Chancellor Allen, thus allows "limited substantive review" of a board's exercise of business judgment in order to determine whether the judgment was "'egregious' or 'irrational' or 'so beyond reason,' etc.," as "a way of inferring bad faith."[74] In other words, "[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."[75]

3. Due Care

Chancellor Allen has also contributed to the evolution of the third element of business judgment rule analysis: the "objective review of the process by which [the board] reached the decision under review (*i.e.*, due care)."[76] Chancellor Allen has noted that there is "no ritual

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71. *Id.* at *42, *reprinted in* 17 DEL. J. CORP. L. at 575.

72. *Id.* at *28, *reprinted in* 17 DEL. J. CORP. L. at 568-69 (quoting *In re* RJR Nabisco, Inc. Shareholders Litig., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,709 (Del. Ch. Jan. 31, 1989), *reprinted in* 14 DEL. J. CORP. L. 1132, 1156 (1989)).

73. Citron v. Fairchild Camera & Instrument Corp., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,915, at 90,091, 90,102 (Del. Ch. May 19, 1988), *reprinted in* 14 DEL. J. CORP. L. 273, 300 (1989), *aff'd*, 569 A.2d 53 (Del. 1989) (citations omitted).

74. *RJR Nabisco*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,710 n.13, *reprinted in* 14 DEL. J. CORP. L. at 1156 n.13.

75. *In re* J.P. Stevens & Co. Shareholders Litig., 542 A.2d 770, 780-81 (Del. Ch. 1988).

76. Cinerama, Inc. v. Technicolor, Inc., No. 8358, 1991 Del. Ch. LEXIS 105, at *28 (Del. Ch. June 21, 1991) (Revised June 24, 1991), *reprinted in* 17 DEL. J. CORP. L. 551, 569 (1992) (quoting *RJR Nabisco*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,709, *reprinted in* 14 DEL. J. CORP. L. at 1156).

in these matters with which thoughtless compliance will assure later judicial approval or from which thoughtful deviation will risk automatic judicial censure.'"[77] Rather, the Chancellor has explained, "in the world of business (as elsewhere), persons are often (or always) required to act on less than perfect or complete information,"[78] since "[i]nformation is not without costs of various kinds. Whether the benefit of additional information is worth the cost—in terms of delay and in terms of alternative uses of time and money—is always a question that may legitimately be addressed by persons charged with decision-making responsibility."[79] The "risks (costs) associated with getting more information" must therefore "be weighed . . . against the likely benefits,"[80] and "the amount of information that it is prudent to have before a decision is made is itself a business judgment" entitled to business judgment rule protection.[81]

Accordingly, in Chancellor Allen's view,

> where a disinterested board in good faith considers the significance of the decision called for, the available information of which it and its advisors are aware and the time constraints imposed upon it, and in those circumstances, the board makes a decision that it *is* in the best interests of the corporation to act, that decision is entitled to the benefits of the business judgment rule.[82]

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77. Citron v. Steego Corp., No. 10,171, 1988 Del. Ch. LEXIS 119, at *26 (Del. Ch. Sept. 9, 1988), *reprinted in* 14 DEL. J. CORP. L. 634, 648 (1989).

78. *Fairchild*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,915, at 90,104, *reprinted in* 14 DEL. J. CORP. L. at 304.

79. Solash v. Telex Corp., [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608, at 97,727 (Del. Ch. Jan. 19, 1988), *reprinted in* 13 DEL. J. CORP. L. 1250, 1263 (1988).

80. *RJR Nabisco*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,714, *reprinted in* 14 DEL. J. CORP. L. at 1165.

81. *Id.*

82. *Fairchild*, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,915, at 90,104, *reprinted in* 14 DEL. J. CORP. L. at 304; *see also Steego*, No. 10,171, 1988 Del. Ch. LEXIS 119, at *26-27, *reprinted in* 14 DEL. J. CORP. L. at 648-49:

> [W]hether the advice of an investment banker would be helpful or not in making a business decision of importance is itself a question demanding business judgment. In some instances—where, for example, the projected market value of a proposed financial instrument forms an important part of the consideration offered to a corporation or its shareholders—one would assume that expertise of a kind found in investment banking houses (and elsewhere) would be invaluable and perhaps essential. Where, however, the transaction offered is all cash and the essential question is the present and

4. The Consequences of the Business Judgment Rule's Presumption

Several of Chancellor Allen's decisions highlight the "powerful"[83] and "enormous substantive law, not just procedural, consequences"[84] of applying the business judgment rule form of judicial review rather than the fairness form of judicial review.

Where the business judgment rule is the governing standard, the Chancellor emphasized, the rule "prevents substantive review of the merits of a business decision,"[85] and requires that courts "decline to evaluate the merits or wisdom of the transaction."[86] "I am driven to this view," the Chancellor has explained, "because I can understand no legitimate basis whatsoever to impose damages (or enter an injunction) if truly disinterested directors have in fact acted in good faith and with due care on a question that falls within the directors' power to manage the business and affairs of the corporation."[87] "To recognize in courts a residual power to review the substance of business decisions for 'fairness' or 'reasonableness' or 'rationality' where those decisions are made by truly disinterested directors in good faith and with appropriate care," according to the Chancellor, "is to make of courts super-directors."[88]

By contrast, where the fairness standard of review governs, judicial consideration of the merits of board decisions does serve a "legitimate" purpose,[89] and "the 'self-dealing' fiduciary must show that the trans-

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future value of the firm, directors with long and intimate contact with the firm may reasonably feel less need for the guidance that nvestment houses may offer.

83. *Solash*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608, at 97,727, *reprinted in* 13 DEL. J. CORP. L. at 1263; *see also* AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. Ch. 1986).

84. Cinerama, Inc. v. Technicolor, Inc., No. 8358, 1991 Del. Ch. LEXIS 105, at *36 (Del. Ch. June 21, 1991) (Revised June 24, 1991), *reprinted in* 17 DEL. J. CORP. L. 551, 572 (1992).

85. *In re* J.P. Stevens & Co. Shareholders Litig., 542 A.2d 770, 780 (Del. Ch. 1988); *see also* Spiegel v. Buntrock, 1988 Del. Ch. LEXIS 149, at *10 (Del. Ch. Nov. 17, 1988), *reargument denied*, No. 8936, 1988 Del. Ch. LEXIS 160 (Del. Ch. Dec. 14, 1988) (observing that the court is ordinarily precluded from exercising substantive judgment about the merits of business decisions when applying the "business judgment" form of judicial review), *aff'd*, 571 A.2d 767 (Del. 1990).

86. *Anderson, Clayton*, 519 A.2d at 111.

87. *In re* RJR Nabisco, Inc. Shareholders Litig., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,710 n.13 (Del. Ch. Jan. 31, 1989), *reprinted in* 14 DEL. J. CORP. L. 1132, 1157 n.13 (1989).

88. *Id.*

89. *Id.*

action was at an entirely fair price. If he cannot do so . . . , he is liable. There is no 'business judgment' defense."[90] Moreover, Chancellor Allen has noted, a shareholder attacking a board decision in the business judgment rule context not only bears the burden of overcoming the business judgment rule's presumption, but also bears the burden of demonstrating gross negligence[91] if the decision is attacked on due care grounds. In the fairness context, according to Chancellor Allen, however, the board bears the burden of proving fairness, and negligence is the governing standard since a director who makes a misjudgment because he was negligent—not grossly negligent—is unlikely to be able to prove fairness.[92]

Chancellor Allen has also observed that the measure of damages in a breach of fiduciary duty action may be implicated by the standard of review. "Under the conventional (business judgment) approach to a claim that an arm's-length sale (of an asset or the company) was at too low a price," according to the Chancellor, "if plaintiff proves negligence and injury, he will . . . only be awarded damages measured by what should have been achieved at that time; rescission will not be available."[93] If directors fail to carry their burden under the fairness test, by contrast,

> they may be liable not simply to compensate the corporation or its shareholders for losses sustained, but . . . may be required to rescind the transaction or pay rescissory damages. This measure, while not definitively described, may certainly exceed loss to the corporation and its shareholders and may, analogously to trust measure of recovery, in some instances, capture defendants' profit from the transaction.[94]

Thus, according to the Chancellor, "the realm of possible liability"[95] in fairness cases, as opposed to business judgment rule cases, "is enormous."[96]

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90. Cinerama, Inc. v. Technicolor, Inc., No. 8358, 1991 Del. Ch. LEXIS 105, at *35-36 (Del. Ch. June 21, 1991) (Revised June 24, 1991), *reprinted in* 17 DEL. J. CORP. L. 551, 572 (1992).

91. *See supra* note 31 and accompanying text.

92. *Technicolor*, No. 8358, 1991 Del. Ch. LEXIS 105, at *35-36, *reprinted in* 17 DEL. J. CORP. L. at 572.

93. *Id.* at *35 (citation omitted).

94. *Id.* at *30, *reprinted in* 17 DEL. J. CORP. L. at 569 (citations omitted).

95. *Id.* at *36, *reprinted in* 17 DEL. J. CORP. L. at 572.

96. *Id.*

In short, as Chancellor Allen observed in *AC Acquisitions Corp. v. Anderson, Clayton & Co.*,[97] "the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of derivative litigation."[98]

II. CHANCELLOR ALLEN, CONTESTS FOR CORPORATE CONTROL, AND CASH-OUT MERGERS

Chancellor Allen has authored a series of opinions involving contests for corporate control and sales or auctions of corporations, including *Paramount Communications, Inc. v. Time, Inc.*,[99] *In re RJR Nabisco, Inc. Shareholders Litigation*,[100] *In re J.P. Stevens & Co. Shareholders Litigation*,[101] *In re Fort Howard Corp. Shareholders Litigation*,[102] and *Roberts v. General Instrument Corp.*[103] These cases provide important examples of Chancellor Allen's views regarding the deference to be accorded under appropriate circumstances to business judgments made by disinterested directors acting in good faith and on an informed basis. The same point is illustrated by a second line of opinions authored by Chancellor Allen, involving cash-out mergers.

A. *Time*

The events underlying Chancellor Allen's 1989 decision in *Paramount Communications, Inc. v. Time Inc.*[104] began in the spring of 1987, when Time's management began discussions with Warner Communications regarding a joint venture between the two companies.[105]

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97. 519 A.2d 103 (Del. Ch. 1986).

98. *Id.* at 111, *quoted in* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1279 (Del. 1989).

99. [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), *aff'd*, 571 A.2d 1140 (Del. 1990).

100. [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,700 (Del. Ch. Jan. 31, 1989), *reprinted in* 14 DEL. J. CORP. L. 1132 (1989).

101. 542 A.2d 770 (Del. Ch. 1988).

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

103. [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).

104. [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), *aff'd*, 571 A.2d 1140 (Del. 1990).

105. *Id.* at 93,267, *reprinted in* 15 DEL. J. CORP. L. at 712.

"Warner by that time had become the focus of Time's strategic thinking,"[106] and by the summer of 1988 Time's management concluded that Time's long-term objectives would best be achieved by merging with an entertainment company, and that Warner "was the most desirable prospect for achieving the corporation's goals."[107]

On March 3, 1989, following months of discussions, the directors of Time and Warner approved a merger agreement pursuant to which Warner would be merged into Time in a stock for stock transaction, with Warner shareholders receiving .465 shares of Time stock per Warner share.[108] Delaware law required the approval of Warner shareholders but not Time shareholders, but a vote of Time shareholders was required pursuant to New York Stock Exchange rules due to the large number of Time shares that would be issued in connection with the merger. The vote by Time shareholders was scheduled for June 23, 1989.[109]

On June 7, 1989, shortly after Time's dissemination of proxy materials in connection with this vote, Paramount Communications announced an all cash tender offer for all shares of Time stock at $175 per share.[110] In one day, the price of Time's stock jumped forty-four points, to $170 per share.[111] On June 16, Time's Board determined that the interests of Time shareholders would be better served by a Time-Warner combination than by an acquisition of Time by Paramount, because the Paramount offer was inadequate, and because of various conditions (including, for example, approvals for the transfer of control of local cable television franchises) attached to the Paramount offer.[112] The Time Board's decision followed receipt of advice from investment advisors, who projected that the combined Time-Warner stock would initially trade at approximately $150 per share (and possibly as high as $160-175 per share), and predicted trading ranges for Time-Warner stock of $106 to $188 in 1990, $159 to $247 in 1991, $230 to $332 in 1992, and $208 to $402 in 1993.[113]

Recognizing that Time's shares were held largely by institutional investors, most of whom "would be tempted by the cash now" offer

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106. *Id.* at 93,267, *reprinted in* 15 DEL. J. CORP. L. at 712-13.
107. *Id.* at 93,267, *reprinted in* 15 DEL. J. CORP. L. at 713.
108. *Id.* at 93,270, *reprinted in* 15 DEL. J. CORP. L. at 717-18.
109. *Id.* at 93,270-71, *reprinted in* 15 DEL. J. CORP. L. at 718, 720.
110. *Id.* at 93,270-71, *reprinted in* 15 DEL. J. CORP. L. at 720.
111. *Id.*
112. *Id.* at 93,272-73, *reprinted in* 15 DEL. J. CORP. L. at 722.
113. *Id.* at 93,272-73, *reprinted in* 15 DEL. J. CORP. L. at 723-24.

and would not be willing to "afford the company's management some additional years to manage the trading value of Time shares to levels materially higher than the future value of $175 now," the Time and Warner Boards determined to restructure the Time-Warner combination in a manner that would not require approval of Time shareholders.[114] Specifically, Time would acquire Warner pursuant to a $70 per share cash tender offer for fifty-one percent of Warner's stock, to be followed by a back-end merger involving a combination of cash and securities worth $70 per share.[115]

Paramount responded to the restructured Time-Warner transaction by increasing its all cash bid for Time to $200 per share. Paramount's $200 per share offer was rejected by Time's Board as inadequate, with the same factors that had led to the board's decision not to pursue a transaction with Paramount at $175 per share continuing to dominate the board's thinking.[116] Time's Board at this point also considered itself legally bound to the Time-Warner transaction, since Time had not negotiated a right to abandon its agreement with Warner in the event that Paramount (or any other potential acquiror) offered Time shareholders a more advantageous alternative than the acquisition by Time of Warner.[117]

Chancellor Allen held that the Time Board's decision to recast the form of its business combination with Warner following the emergence of Paramount's unsolicited offer was subject to the "innovative and important"[118] *Unocal Corp. v. Mesa Petroleum Co.*[119] standard of judicial review. Time's Board was thus required to demonstrate that it had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed," and that the defensive measure decided upon was "reasonable in relation to the threat posed."[120] The Chancellor reached this conclusion despite the fact that "the original Time-Warner merger agreement was . . . chiefly motivated by strategic business concerns" rather than "reducing vulnerability to unsolicited takeovers . . . ."[121]

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114. *Id.* at 93,273-74, *reprinted in* 15 DEL. J. CORP. L. at 726-27.
115. *Id.* at 93,265, 93,274, *reprinted in* 15 DEL. J. CORP. L. at 706, 727.
116. *Id.* at 93,275, *reprinted in* 15 DEL. J. CORP. L. at 728.
117. *Id.*
118. *Id.* at 93,282, *reprinted in* 15 DEL. J. CORP. L. at 745.
119. 493 A.2d 946 (Del. 1985).
120. *Id.* at 955; *see supra* notes 36-44 and accompanying text.
121. *Time*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,282, *reprinted in* 15 DEL. J. CORP. L. at 744.

Chancellor Allen thus addressed two questions in his analysis of the Time Board's conduct: (1) "Does the Paramount all cash, all shares offer represent a threat to an interest the board has an obligation or a right to protect by defensive action?,"[122] and (2) "Is the Warner tender offer a reasonable step in the circumstances?"[123]

With respect to the first question, Chancellor Allen concluded that the Paramount offer endangered "achievement of the long-term strategic plan of the Time-Warner consolidation which was plainly a most important corporate policy."[124] The Chancellor acknowledged that the Time Board's determination regarding how to effectuate this policy following the emergence of Paramount's offer was "reactive in important respects (and thus must withstand a *Unocal* analysis)."[125] The Chancellor emphasized, however, that this "reactive" policy had "its origin and central purpose in *bona fide* strategic business planning, and not in questions of corporate control,"[126] and that a board managing a corporation "for long-term profit pursuant to a preexisting business plan that itself is not primarily a control device or scheme . . . has a legally cognizable interest in achieving that plan."[127] Paramount's offer was therefore held to constitute a "threat" to shareholder interests which justified reasonable board action "to protect transactions contemplated by such plan"—the planned Time-Warner combination.[128]

With respect to the second question, Chancellor Allen held that an evaluation of Time's response to the threat posed by Paramount's offer required "an evaluation of the importance of the corporate objective threatened; alternative methods for protecting that objective; impacts of the 'defensive' action and other relevant factors."[129] The Chancellor emphasized the need to make this evaluation "cautiously," in order to ensure that "the important benefits of the business judgment rule (including designation of authority to make business and financial decisions to . . . boards of directors, with substantive expertise)" not "be eroded or lost by slow degrees."[130]

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122. *Id.* at 93,282, *reprinted in* 15 DEL. J. CORP. L. at 746.
123. *Id.* at 93,283, *reprinted in* 15 DEL. J. CORP. L. at 748.
124. *Id.*
125. *Id.*
126. *Id.*
127. *Id.*
128. *Id.*
129. *Id.*
130. *Id.*

Here, the Chancellor concluded, "the objective—realization of the company's major strategic plan—is reasonably seen as of unquestionably great importance by the board," and the "reactive step taken was effective but not overly broad."[131] The Chancellor continued:

> The board did only what was necessary to carry forward a preexisting transaction in an altered form. That "defensive" step does not legally preclude the successful prosecution of a hostile tender offer. And while effectuation of the Warner merger may practically impact the likelihood of a successful takeover of the merged company, it is not established in this record that that is foreclosed as a practical matter.[132]

The Chancellor distinguished cases in which boards had

> sought to assure continued control by compelling a transaction that itself would have involved the sale of substantial assets, an enormous increase in debt and a large cash distribution to shareholders. In other words, in 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 threat to the corporation.[133]

On this basis, the Chancellor held that "the revised merger agreement and the Warner tender offer . . . represent actions that are reasonable in relation to the specific threat posed to the Warner merger by the Paramount offer."[134]

Chancellor Allen concluded with a strong endorsement of business judgment rule principles:

> The value of a shareholder's investment, over time, rises or falls chiefly because of the skill, judgment and perhaps luck—for it is present in all human affairs—of the management and directors of the enterprise. When they exercise sound or brilliant judgment, shareholders are likely to profit; when they fail to do so, share values likely will fail to appreciate. In either event, the financial vitality of the corporation and the value of the company's shares is in the

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131. *Id.* at 93,284, *reprinted in* 15 DEL. J. CORP. L. at 749.
132. *Id.*
133. *Id.* at 93,283, *reprinted in* 15 DEL. J. CORP. L. at 747.
134. *Id.* at 93,284, *reprinted in* 15 DEL. J. CORP. L. at 749.

> hands of the directors and managers of the firm. The corporation law does not operate on the theory that directors, in exercising their powers to manage the firm, are obligated to follow the wishes of a majority of shares. In fact, directors, not shareholders, are charged with the duty to manage the firm.
>
> In the decision they have reached here, the Time board may be proven in time to have been brilliantly prescient or dismayingly wrong. In this decision, as in other decisions affecting the financial value of their investment, the shareholders will bear the effects for good or ill. That many, presumably most, shareholders would prefer the board to do otherwise than it has done does not . . . afford a basis to interfere with the effectuation of the board's business judgment.[135]

The Delaware Supreme Court affirmed Chancellor Allen's decision, noting that Time's Board had "reasonably determined" that Paramount's offer posed several threats to shareholders, including (1) inadequate value, (2) the possibility that shareholders might elect to tender their shares to Paramount "in ignorance or a mistaken belief of the strategic benefit which a business combination with Warner might produce," (3) conditions attached to Paramount's all cash offer which introduced "a degree of uncertainty that skewed a comparative analysis" between the two proposed transactions, and (4) the arguable timing of the "eleventh hour" Paramount offer "to upset, if not confuse, the Time stockholders' vote."[136] The Time Board's response to these threats, the supreme court concluded, was "reasonably related" to these threats, since "on the record facts, the Chancellor found that Time's responsive action to Paramount's tender offer was not aimed at 'cramming down' on its shareholders a management-sponsored alternative, but rather had as its goal the carrying forward of a pre-existing transaction in an altered form."[137]

B. Corporate Auctions

The Delaware Supreme Court announced in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[138] that if a "sale" or "break-up"

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135. *Id.* at 93,284, *reprinted in* 15 DEL. J. CORP. L. at 749-50 (citations omitted).

136. Paramount Communications Inc. v. Time Inc., 571 A.2d 1140, 1153 (Del. 1990).

137. *Id.* at 1154-55.

138. 506 A.2d 173 (Del. 1986).

of a corporation becomes "inevitable," the board's duty changes "from the preservation of [the corporation] as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit."[139] The court observed that under such circumstances the board's responsibilities are altered significantly:

> [The corporation] no longer face[s] threats to corporate policy and effectiveness, or to the stockholders' interests, from a grossly inadequate bid. The whole question of defensive measures [becomes] moot. The directors' role [is] changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.[140]

The court added, however, that "[t]he directors' role remains an active one, changed only in the respect that they are charged with the duty of selling the company at the highest price attainable for the stockholders' benefit."[141]

The doctrine announced in *Revlon* was articulated in more detail by the Delaware Supreme Court in *Paramount Communications, Inc. v. Time Inc.*,[142] a case discussed in a different context above.[143] The supreme court in *Time* explained that "generally speaking and without excluding other possibilities, two circumstances . . . may implicate" a duty under *Revlon* to conduct an auction.[144] First, the *Time* court stated, a duty under *Revlon* arises when a corporation "initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company."[145] Second, a duty under *Revlon* also arises "when in response to a bidder's offer, a [corporation] abandons its long-term strategy and seeks an alternative transaction involving the breakup of the company."[146] The court emphasized, however, that where "the board's reaction to a hostile tender offer is found to constitute only a defensive response and not an abandonment of the corporation's continued existence, *Revlon* duties are not triggered."[147] The court expressly declined "to extend *Revlon*'s

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139. *Id.* at 182.
140. *Id.*
141. *Id.* at 184 n.16.
142. 571 A.2d 1140 (Del. 1990).
143. *See supra* notes 104-37 and accompanying text.
144. *Time*, 571 A.2d at 1150.
145. *Id.*
146. *Id.*
147. *Id.* at 1150.

application to corporate transactions simply because they might be construed as putting a corporation either 'in play' or 'up for sale.'"[148]

The Delaware Supreme Court's decision in *Mills Acquisition Co. v. Macmillan, Inc.*[149] addresses the parameters within which a board conducting an auction must act, and emphasizes the importance in this context of "the most scrupulous adherence to ordinary standards of fairness in the interest of promoting the highest values reasonably attainable for the stockholders' benefit."[150] The *Macmillan* court recognized, however, that "the conduct of a corporate auction is a complex undertaking both in its design and execution,"[151] and that no "standard formula" is required.[152] To the contrary, the court emphasized, directors conducting an auction possess "broad negotiating authority" to secure "the best price available to the stockholders," and are free to "benefit one bidder over another" so long as the board's "primary objective" and "essential purpose" remains "the enhancement of the bidding process for the benefit of the stockholders."[153]

The board's conduct in this regard, according to the *Macmillan* court, is evaluated pursuant to a modified version of the *Unocal Corp. v. Mesa Petroleum Co.*[154] rule.[155] Once a plaintiff demonstrates that competing bidders have been treated on unequal terms, the court must examine (1) whether the corporation's board "properly perceived that shareholder interests were enhanced" by unequal treatment of competing bidders, and (2) whether the board's action was "reasonable in relation to the advantage sought to be achieved or conversely to the threat which a particular bid allegedly pose[d] to stockholder interests."[156] If the answers to both of these questions are "yes," then the directors' actions "are entitled to the protection of the business judgment rule."[157]

Chancellor Allen has considered board conduct of auctions (defined broadly, to include both auctions and board decisions to accept management offers conditioned upon "market test" or "market check"

148. *Id.* at 1151.
149. 559 A.2d 1261 (Del. 1989).
150. *Id.* at 1264.
151. *Id.* at 1287.
152. *Id.* at 1286.
153. *Id.* at 1287.
154. 493 A.2d 946 (Del. 1985).
155. *See supra* notes 36-44 and accompanying text.
156. *Macmillan*, 559 A.2d at 1288.
157. *Id.*

provisions pursuant to which the offers are subject to a post-agreement probing of the market for a specified period of time) in four cases, three before *Macmillan*—*In re RJR Nabisco, Inc. Shareholders Litigation*,[158] *In re J.P. Stevens & Co. Shareholders Litigation*,[159] and *In re Fort Howard Corp. Shareholders Litigation*[160]—and one after *Macmillan*—*Roberts v. General Instrument Corp.*[161]

Chancellor Allen's decision in *In re RJR Nabisco, Inc. Shareholders Litigation*,[162] upholding a transaction the total value of which was "by all measures extraordinary—approximately $25 billion,"[163] illustrates the broad latitude the Chancellor has provided directors conducting *Revlon*-type auctions. The events underlying the *RJR Nabisco* decision began on October 19, 1988, when an RJR management group informed RJR's Board that the management group was considering a leveraged buy-out of the company at a $75 per share price, or approximately $20 above the price at which RJR's stock recently had been trading.[164] On October 20, RJR's Board issued a press release announcing the proposed transaction, and on October 24, Kohlberg Kravis Roberts & Co. (KKR) announced that it intended to make an offer at $90 per share in cash for up to eighty-seven percent of RJR's stock, with the remainder of RJR's stock to be exchanged for new securities in a second step merger.[165] A special committee of outside directors of RJR disseminated rules and procedures for submission of bids in a single round of bidding by management, KKR and any other interested bidder before November 18.[166]

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158. [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,700 (Del. Ch. Jan. 31, 1989), *reprinted in* 14 DEL. J. CORP. L. 1132 (1989).

159. 542 A.2d 770 (Del. Ch. 1988).

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

161. [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). The Delaware Supreme Court observed in *Macmillan* that it was "not altogether clear" that the court of chancery had "*explicitly* applied the enhanced *Unocal* standard" in reviewing the board decisions at issue in *RJR Nabisco*, *J.P. Stevens*, and *Fort Howard* (and several other cases decided by the court of chancery, but not by Chancellor Allen). *Macmillan*, 559 A.2d at 1287-88. "On the surface," the supreme court noted, "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*." *Id.* at 1288.

162. [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194, at 91,700 (Del. Ch. Jan. 31, 1989), *reprinted in* 14 DEL. J. CORP. L. 1132 (1989).

163. *Id.* at 91,701, *reprinted in* 14 DEL. J. CORP. L. at 1137.

164. *Id.* at 91,703, *reprinted in* 14 DEL. J. CORP. L. at 1142.

165. *Id.*

166. *Id.* at 91,703, *reprinted in* 14 DEL. J. CORP. L. at 1143.

Three bids were presented to the special committee on November 18. The first bid was a $100 per share management group proposal consisting of $90 in cash, $6 in preferred stock, and $4 in convertible preferred stock.[167] The second bid was a $94 per share KKR proposal consisting of $75 in cash, $11 in preferred stock, and $8 in convertible debentures.[168] The third bid was a First Boston proposal contemplating sales of RJR's food and tobacco businesses. The terms of First Boston's proposal were not fully worked out and faced time constraints imposed by impending tax law changes, but the proposal's total value was estimated to be in the range of $98 to $110 in cash and cash equivalents, securities valued at $5, and warrants valued at $2-$3, or a total of $98 to $110.[169] RJR's special committee determined that the First Boston bid was potentially the most attractive of the three proposals it had received, and decided to extend bidding until November 29 in order to allow First Boston more time to develop its proposal.[170]

Three new bids were accordingly presented to the special committee on November 29. The management group bid $101 per share, consisting of $88 in cash, $9 in preferred stock, and $4 in convertible preferred stock.[171] KKR bid $106 per share, consisting of $80 in cash, $17 in preferred stock, and $9 in convertible debentures.[172] The First Boston proposal was valued by First Boston in the range of $103 to $115.[173]

The special committee concluded that the First Boston bid was too uncertain to be practicable, and that the KKR bid was worth more than the management group bid, if the securities included in these two bids were worth what the bidders claimed.[174] The committee directed its advisors to negotiate with KKR concerning the terms of the securities and the details of a merger agreement, and negotiations were conducted during the evening of November 29 and the morning of November 30.[175] The management group, however, learned that the special committee and KKR were negotiating, and advised the

167. *Id.* at 91,704, *reprinted in* 14 DEL. J. CORP. L. at 1144.
168. *Id.* at 91,704, *reprinted in* 14 DEL. J. CORP. L. at 1143.
169. *Id.*
170. *Id.* at 91,704, *reprinted in* 14 DEL. J. CORP. L. at 1144.
171. *Id.*
172. *Id.*
173. *Id.*
174. *Id.*
175. *Id.*

special committee that it intended to make another proposal.[176] The special committee responded by announcing that it would waive the previously set November 29 time limit for new bids, and would consider new bids from either party.[177]

A flurry of bids by both parties followed during the course of November 30, and by that evening two proposals were on the table: a $112 per share management group proposal consisting of $84 in cash, $24 in preferred stock, and $4 in convertible preferred stock,[178] and a $109 per share KKR proposal consisting of $81 in cash, $18 in preferred stock, and $10 in convertible debentures.[179] The special committee's investment advisors determined that the management group bid could be discounted from $112 to $108.50-109 per share, and that the KKR bid could be discounted from $109 to $108-108.50 per share.[180] Factoring the unprecedented size of the debt offerings of high yield securities and the inherent limitations of predicting future markets into their analysis, the advisors concluded and reported to the committee that the two bids were "substantially equivalent" from a financial point of view, and that both bids were fair to RJR shareholders.[181]

The committee then determined to recommend the KKR bid, based upon its consideration of several factors:

- further negotiations could result in either party withdrawing from the bidding process;
- KKR was offering a greater equity interest than the management group;
- KKR would retain RJR's tobacco business and a substantial part of its food businesses, while the management group would only retain the tobacco business;
- RJR's debt indentures raised issues in connection with the management group proposal but not in connection with the KKR proposal; and
- KKR, but not the management group, was willing to provide for the preservation of benefits for employees who would be terminated due to business divestitures.[182]

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176. *Id.*
177. *Id.* at 91,705, *reprinted in* 14 DEL. J. CORP. L. at 1145.
178. *Id.* at 91,705-06, *reprinted in* 14 DEL. J. CORP. L. at 1148.
179. *Id.* at 91,706-07, *reprinted in* 14 DEL. J. CORP. L. at 1149.
180. *Id.* at 91,708, *reprinted in* 14 DEL. J. CORP. L. at 1152.
181. *Id.*
182. *Id.* at 91,708, *reprinted in* 14 DEL. J. CORP. L. at 1152-53.

RJR's Board followed the committee's recommendation, and accepted the KKR bid.[183]

Upholding the committee's and the board's determination to conclude the auction at a time when two bidders were tied with substantially equivalent bids, Chancellor Allen rejected a contention that the directors had not acted with due care because "the auction could have continued and more information might have been gotten about what could be achieved."[184] The Chancellor acknowledged that more information might have been attained, but stated that seeking this information might have had a cost—one of the parties walking away.[185] The Chancellor noted the "amount of attention the directors lavished upon this important transaction and the responsible steps they took to be competently advised concerning alternatives open to them,"[186] and concluded that under these circumstances, the decision that the risks of seeking more information outweighed the potential reward in having that information was a business decision entitled to the protection of the business judgment rule.[187]

The Chancellor likewise upheld the decision to accept the KKR proposal rather than the management group proposal, despite the management group proposal's higher value ($108.50 to 109 per share versus $108 to 108.50 per share) and higher cash component ($84 versus $81 per share), since "[t]he larger equity stub, the different future business plans of the two bidders, and the superior [terms] of KKR's proposed converting debentures, all provide a basis to support the notion that the choice was a rational one," and not one "so beyond the bounds of reasonable judgment as to raise an inference of bad faith."[188]

In re J.P. Stevens & Co. Shareholders Litigation[189] involved a contest for control of J.P. Stevens & Co., Inc. between West Point-Pepperell and Odyssey Partners. On March 21, 1988, following three rounds of bidding,[190] a special committee of the J.P. Stevens Board determined that a $61 per share Odyssey proposal presented "a better deal—more likely to close and to do so sooner—" than a $62.50 per share

183. *Id.* at 91,708, *reprinted in* 14 DEL. J. CORP. L. at 1153.
184. *Id.* at 91,713-14, *reprinted in* 14 DEL. J. CORP. L. at 1165.
185. *Id.* at 91,714, *reprinted in* 14 DEL. J. CORP. L. at 1165.
186. *Id.* at 91,713-14, *reprinted in* 14 DEL. J. CORP. L. at 1163-64.
187. *Id.* at 91,713, *reprinted in* 14 DEL. J. CORP. L. at 1165-66.
188. *Id.* at 91,713, *reprinted in* 14 DEL. J. CORP. L. at 1163.
189. 542 A.2d 770 (Del. Ch. 1988).
190. *Id.* at 773-75.

proposal by West Point, due to potential antitrust problems that could delay or prevent a merger between J.P. Stevens and West Point.[191] Further negotiations resulted in a $61.50 per share offer by Odyssey, and a merger agreement was entered into by J.P. Stevens and Odyssey at that price.[192] The agreement contained a "fiduciary out" clause permitting J.P. Stevens to terminate its obligation to complete the merger if a superior bid were received.[193]

West Point responded by entering into an agreement with NTC Group, Inc. that contemplated the sale of the portion of J.P. Stevens' business that posed the antitrust concerns that had led to J.P. Stevens' rejection of West Point's $62.50 per share proposal.[194] West Point advised J.P. Stevens that it was prepared to increase its price to $64 per share, and that its "arrangement with NTC 'eliminated any antitrust concerns' and made it 'virtually certain' that the transaction would be consummated."[195] Odyssey responded with a definitive bid for $64, with Odyssey to receive a "topping fee" of twenty percent of any amount over $64 that Stevens shareholders ultimately received, with the total topping fee capped at $8 million, or $0.40 per share.[196] Odyssey's offer provided that it would lapse if not accepted within one day, or if West Point were informed of the offer.[197]

A special committee of J.P. Stevens' Board, and then the board itself, concluded that antitrust concerns continued to present risks rendering West Point's proposal less advantageous than Odyssey's proposal, and determined to accept Odyssey's $64 per share proposal without asking West Point whether it would increase its offer.[198] The parties' $64 per share merger agreement did, however, contain a "fiduciary out" clause permitting acceptance by J.P. Stevens of a superior offer.[199]

Chancellor Allen acknowledged that "the topping fee provision clearly does have the effect of favoring Odyssey in the bidding and may preclude West Point from offering a price that it might otherwise offer," but concluded that the topping fee "is not, in my opinion,

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191. *Id.* at 775-76.
192. *Id.* at 776.
193. *Id.*
194. *Id.* at 776-77.
195. *Id.*
196. *Id.* at 777.
197. *Id.* at 778.
198. *Id.*
199. *Id.*

inconsistent with the board's duty to seek the best available transaction for the shareholders."[200] Chancellor Allen explained that if a bidder "will not participate further in bidding without some special consideration," then "without the inducement, the shareholders are left without a bidder and perhaps no auction, or at least a reduced likelihood of a continued auction."[201]

Applying this principle to the facts at issue in *J.P. Stevens*, the Chancellor reasoned as follows:

> As of March 28, the Special Committee had in hand a merger agreement contemplating $61.50 cash per Stevens share. It also had an indication that another bidder, West Point, was willing to go to $64 per share. There were no other bidders willing to compete at levels above $61.50. Failure to get Odyssey to increase its offer to $64 would have meant that, even if the Special Committee could have succeeded in getting West Point to legally commit itself to a $64 deal, there was no reasonable prospect for another bidder forcing the bidding beyond that point. If, however, Odyssey could be induced to increase its offer to $64, two bidders were left in the game willing to pay at least that price. A prospect for a price greater than $64, thus, still remained. It therefore appeared critical, in order to possibly achieve a price *in excess* of $64, to get Odyssey up to that price. If, in order to do so, it required a topping fee calculated as a percentage of amounts realized above $64, it was not unreasonable for the Special Committee to conclude that the shareholders could only gain by granting that fee and could lose nothing. The shareholders would end up . . . with a committed cash deal at $64, the highest price that anyone had suggested up until that time, and would maintain a prospect for further bidding among two still-active candidates. Failure to get Odyssey to $64 would have terminated the matter with West Point's $64 bid (assuming it could be realized should Odyssey be seen as unwilling to go above $61.50).[202]

The Chancellor concluded by emphasizing that such negotiating strategies are "precisely the sort of debatable questions that are beyond

200. *Id.* at 782.
201. *Id.* at 782 n.8.
202. *Id.* at 782.

the expertise of courts and which the business judgment rule generally protects from substantive review for wisdom."[203]

In re Fort Howard Corp. Shareholders Litigation[204] and *Roberts v. General Instrument Corp.*[205] both involved "market test" or "market check" provisions in merger agreements entered into with management-backed groups without full and open bidding contests, with these provisions designed to facilitate an affirmative probing of the market for later, better offers as a means of testing the fairness of the management-backed offer.

The market check agreement in *Fort Howard* provided that a special committee of outside directors,[206] acting on behalf of the corporation, could not solicit potential acquirors, but could "for a period of thirty business days after announcement (forty-three calendar days) . . . negotiate with, and provide information to, any potential acquiror who contacted the Company."[207] If a competing bidder outbid the management group, the merger agreement entered into by the corporation and the management group provided that the management group would be entitled to a termination fee of up to $67.8 million, or approximately $1 per share.[208] Chancellor Allen found that the company's press release announcing the merger agreement "ma[d]e clear . . . that the Company ha[d] the right and would entertain alternative proposals and would cooperate with any such person in the development of a competing bid."[209] Chancellor Allen also found that this press release and the news accounts of the press release had

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203. *Id.* at 783.

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

205. [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).

206. Chancellor Allen was critical of the fact that the corporation's chief executive officer, who was a participant in the management leveraged buy-out transaction, had selected the members of the special committee and its counsel. *Fort Howard*, No. 9991 (Consolidated), 1988 Del. Ch. LEXIS 110, at *36-38, *reprinted in* 14 DEL. J. CORP. L. at 719-20. The Chancellor noted that "[a] suspicious mind is made uneasy contemplating the possibilities when the interested CEO is so active in choosing his adversary." *Id.* at *36, *reprinted in* 14 DEL. J. CORP. L. at 720. Here, however, the Chancellor determined to "draw no inference of bad faith on the part of the Special Committee" because the course of conduct pursued by the committee "was reasonably calculated to (and did) effectively probe the market for alternative possible transactions." *Id.* at *37, *reprinted in* 14 DEL. J. CORP. L. at 720.

207. *Id.* at *19, *reprinted in* 14 DEL. J. CORP. L. at 712.

208. *Id.*

209. *Id.* at *22, *reprinted in* 14 DEL. J. CORP. L. at 713.

received widespread attention, and that the special committee had received eight inquiries but no competing bids.[210]

The Chancellor held that the course pursued by the special committee was "reasonably calculated to (and did) effectively probe the market for alternative possible transactions."[211] Chancellor Allen stated:

> The alternative "market check" that was achieved was not so hobbled by lock-ups, termination fees or topping fees; so constrained in time or so administered (with respect to access to pertinent information or manner of announcing "window shopping" rights) as to permit the inference that this alternative was a sham designed from the outset to be ineffective or minimally effective.[212]

The Chancellor added that he was "particularly impressed with the [corporation's] announcement in the financial press and with the rapid and full-hearted response to the eight inquiries received. Very full information was provided very promptly."[213]

The Chancellor also held that the special committee's rationale for permitting negotiations with the management buy-out group before turning to the market "ma[d]e sense," and could not "justify an inference of bad faith."[214] The Chancellor explained that "[m]anagement had proposed to make an all cash bid for all shares if and only if the board endorsed it," but "[t]he rest of the world was not bound by any of these three important qualifications"—i.e., an all cash, all shares, board endorsement.[215] "To start a bidding contest before it was known that an all cash bid for all shares could and would be made," the Chancellor concluded, would have "increase[d] the risk of a possible takeover attempt at less than a 'fair' price or for less than all shares."[216]

The same result was reached by Chancellor Allen in *Roberts v. General Instrument Corp.*,[217] a case involving Forstmann Little's acquisition of General Instrument Corporation. While not technically a

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210. *Id.* at *23-28, *reprinted in* 14 DEL. J. CORP. L. at 713-16.
211. *Id.* at *37, *reprinted in* 14 DEL. J. CORP. L. at 720.
212. *Id.* at *37-38, *reprinted in* 14 DEL. J. CORP. L. at 720.
213. *Id.* at *38, *reprinted in* 14 DEL. J. CORP. L. at 720.
214. *Id.* at *38, *reprinted in* 14 DEL. J. CORP. L. at 721.
215. *Id.* at *38-39, *reprinted in* 14 DEL. J. CORP. L. at 721.
216. *Id.*
217. [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).

management leveraged buy-out transaction, Chancellor Allen treated the transaction as if it were one, because General Instrument's Chief Executive Officer "had every reason to hope"[218] that an agreement might be reached between Forstmann and General Instrument's management concerning employment and equity participation in the company.[219]

The parties' merger agreement provided that (1) General Instrument would not solicit alternative bidders, (2) General Instrument's directors and officers would not participate in discussions with or provide any information to alternative bidders except to the extent required by their fiduciary duties to shareholders, (3) General Instrument's Board could terminate the agreement if it determined that an alternative bidder's tender offer or written offer to merge provided the company's shareholders with more favorable terms than the terms agreed to with Forstmann, and (4) General Instrument would pay Forstmann a $33 million break-up fee in the event General Instrument terminated the agreement.[220] A press release announcing the General Instrument-Forstmann agreement included the following paragraph: "Pursuant to the Merger Agreement, Forstmann Little will be paid a commitment fee of $33 million in the event that the Board of Directors of General Instrument Corporation receives an unsolicited higher offer and accepts that offer pursuant to the exercise of its fiduciary responsibilities."[221] Chancellor Allen noted that the terms of this press release were "actively negotiated," with General Instrument seeking "a more inviting release" and Forstmann "interested in not inspiring competing proposals."[222]

Chancellor Allen began his analysis in *General Instrument* by stating that under *Mills Acquisition Co. v. Macmillan, Inc.*[223]—which the Delaware Supreme Court had decided after the Chancellor's *RJR*, *J.P. Stevens*, and *Fort Howard* decisions—a post-merger agreement market check procedure "constitutes discrimination in favor of the party acquiring rights under the merger agreement," and thus mandates inquiry "whether the circumstances afford a disinterested and well motivated director a basis reasonably to conclude that if the transactions contemplated by the merger agreement close, they will represent the

218. *Id.* at 97,405, *reprinted in* 16 DEL. J. CORP. L. at 1555-56.
219. *Id.*
220. *Id.* at 97,403, *reprinted in* 16 DEL. J. CORP. L. at 1552.
221. *Id.* at 97,403, *reprinted in* 16 DEL. J. CORP. L. at 1551 (footnote omitted).
222. *Id.* at 97,403 n.4, *reprinted in* 16 DEL. J. CORP. L. at 1551 n.4.
223. 559 A.2d 1261 (Del. 1989); *see supra* notes 149-57 and accompanying text.

best available alternative for the corporation and its shareholders."[224] This inquiry, the Chancellor explained,

> involves consideration *inter alia* of the nature of any provisions in the merger agreement tending to impede other offers, the extent of the board's information about market alternatives, the content of announcements accompanying the execution of the merger agreement, the extent of the company's contractual freedom to supply necessary information to competing bidders, and the time made available for better offers to emerge.[225]

Denying a motion for preliminary injunctive relief, Chancellor Allen emphasized that General Instrument's Board had created a special committee consisting of the eight non-management directors on the corporation's eleven member board, and that the record "does not supply sufficient basis to conclude preliminarily that the preponderant part of the board that acted as a special committee here was manipulated by the (assumedly) interested CEO," or was "uninformed or inappropriately motivated."[226] The Chancellor emphasized that "the merger agreement contained a sufficient fiduciary out, a limited (2%) break-up fee and a sufficient extension of the closing date of the tender offer to permit the board reasonably to conclude that if this deal closed it would represent the best available transaction."[227] The Chancellor also noted that two interested parties had requested and "were quickly given full information" pursuant to the same terms upon which the information had been given to Forstmann Little, and that neither of these two parties had made a competing offer.[228]

C. *Cash-Out Mergers*

A "cash-out" merger (also called a "freeze-out" or "take-out" merger) is a merger pursuant to which a controlling shareholder requires minority shareholders to give up their equity in the corporation in exchange for cash or securities, while the controlling shareholder retains its equity. Cash-out transactions are not protected by the

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224. *Roberts*, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,465, at 97,404-05, *reprinted in* 16 DEL. J. CORP. L. at 1555.
225. *Id.* at 97,405, *reprinted in* 16 DEL. J. CORP. L. at 1555.
226. *Id.* at 97,405, *reprinted in* 16 DEL. J. CORP. L. at 1556.
227. *Id.* at 97,405, *reprinted in* 16 DEL. J. CORP. L. at 1556.
228. *Id.* at 97,403, *reprinted in* 16 DEL. J. CORP. L. at 1553.

business judgment rule because an individual shareholder who is interested in the transaction controls a majority of the corporation's board. As a result, the controlling shareholder has the burden of demonstrating the fairness of the transaction or securing the informed approval of a majority of either disinterested directors or minority shareholders.[229]

The Delaware Supreme Court's landmark 1983 decision in *Weinberger v. UOP, Inc.*,[230] summarized the necessary showing of fairness in these cases as follows:

> The concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed [transaction], including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock. However, the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.[231]

The Delaware Supreme Court's 1985 decision in *Rosenblatt v. Getty Oil Co.*[232] reaffirmed these principles,[233] and also addressed the allocation of the burden of proof on the fairness issue. According to the *Rosenblatt* court, "approval of a merger . . . by an informed vote of a majority of the minority shareholders . . . shifts the burden of proving the unfairness of the merger entirely to the plaintiffs," and the use of disinterested directors to ensure "adversarial" negotiations with "contending parties to the merger in fact exert[ing] their bargaining power against one another at arm's length . . . may give rise to the proposition that the directors' actions are more appropriately measured by business judgment standards."[234]

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229. *See, e.g.*, Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 846 (1987); Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985); Weinberger v. UOP, Inc., 457 A.2d 701, 703, 710 n.7 (Del. 1983).

230. 457 A.2d 701 (Del. 1983).

231. *Id.* at 711 (citations omitted).

232. 493 A.2d 929 (Del. 1985).

233. *Id.* at 937.

234. *Id.* at 937-38.

While Vice-Chancellor Jack B. Jacobs has held that the approval of a controlling shareholder transaction by a special committee of disinterested directors shifts the burden of proof to the plaintiff to demonstrate "unfairness" but does not implicate business judgment rule considerations,[235] Chancellor Allen has held in *In re Trans World Airlines Shareholder Litigation*[236] that "the device of the special negotiating committee of disinterested directors" has "the judicial effect of making the substantive law aspect of the business judgment rule applicable and, procedurally, of shifting back to plaintiffs the burden of demonstrating that such a transaction infringes upon rights of minority shareholders."[237] The Chancellor noted in *TWA* that "[b]y referring to the substantive aspects of the rule, I refer to the fact that the burden that is shifted back to plaintiffs . . . is a particular and a particularly difficult one."[238]

Chancellor Allen in *Freedman v. Restaurant Associates Industries, Inc.* (*Restaurant Associates I*)[239] and *Cinerama, Inc. v. Technicolor, Inc.*[240] similarly endorsed the business judgment rule standard of review in controlling shareholder cases in which a special committee has been properly employed.[241] As the Chancellor explained in *Technicolor*:

> [W]hen a court determines that in fact a controlling shareholder has not resorted to that power, because a special committee functioned and that special committee in fact understood its duty and power (*i.e.*, to say no when a proposed transaction is not both fair and the best deal that can be negotiated) and satisfied that duty, then it is that process that protects the minority shareholders, subject to

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235. Citron v. E.I. DuPont de Nemours & Co., 584 A.2d 490, 500-02 (Del. Ch. 1990).

236. No. 9844 (Consolidated), 1988 Del. Ch. LEXIS 139 (Del. Ch. Oct. 21, 1988), *reprinted in* 14 DEL. J. CORP. L. 870 (1989).

237. *Id.* at *19, *reprinted in* 14 DEL. J. CORP. L. at 883.

238. *Id.*

239. [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,502, at 97,214 (Del. Ch. Oct. 16, 1987) (*Restaurant Assocs. I*), *reprinted in* 13 DEL. J. CORP. L. 651 (1988), *subsequent proceedings*, Freedman v. Restaurant Assocs. Indus., Inc., [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,617, at 97,882 (Del. Ch. Sept. 19, 1990) (*Restaurant Assocs. II*), *reprinted in* 16 DEL. J. CORP. L. 1462 (1991).

240. No. 8358, 1991 Del. Ch. LEXIS 105 (Del. Ch. June 21, 1991) (Revised June 24, 1991), *reprinted in* 17 DEL. J. CORP. L. 551 (1992).

241. *Id.* at *64, *reprinted in* 17 DEL. J. CORP. L. at 586; *Restaurant Assocs. I*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,502, at 97,220, *reprinted in* 13 DEL. J. CORP. L. at 664.

> business judgment review. If courts exercise sensitive review to determine whether, in fact, that process itself was effectively employed, this dichotomy between the use of power and its non-use is fully consistent with the full protection of shareholder interests, while freeing the court, where feasible, from the difficult burden of adjudicating substantive fairness in business transactions. In this effort, courts must be probing and, indeed suspicious. But that attitude of suspicion ought not, in my judgment, go so far as to assume that the process of special committees is inherently invalid.[242]

The Chancellor's willingness to apply business judgment rule principles and avoid second-guessing special committee decisions in the controlling shareholder context is thus bounded by the Chancellor's insistence upon "sensitive" threshold judicial review. This review, the Chancellor explained, determines "whether, in fact, that process itself was effectively employed"[243] and supplies "an acceptable surrogate for the energetic, informed and aggressive negotiation that one would reasonably expect from an arm's-length adversary," which "aggressively seek[s] to promote and protect minority interests."[244] By contrast, "[w]here a special committee is passive or its charter from the board unduly restricts it, the work of the committee may be accorded no effect."[245]

Thus, for example, the Chancellor refused "to pass upon the wisdom of business decisions" in *Restaurant Associates I*[246] and in *TWA* described the special committee procedure as having "work[ed] well" in *Restaurant Associates I*.[247] In *TWA*, however, the Chancellor held that "no weight may be accorded" to the actions of the special committee in that case, because the committee had neither engaged in "energetic, informed and aggressive negotiation" nor "aggressively [sought] to promote and protect minority interests."[248]

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242. *Technicolor*, No. 8358, 1991 Del. Ch. LEXIS 105, at *64-65, *reprinted in* 17 DEL. J. CORP. L. at 586 (citations omitted).

243. *Id.* at *64, *reprinted in* 17 DEL. J. CORP. L. at 586.

244. *TWA*, No. 9844 (Consolidated), 1988 Del. Ch. LEXIS 139, at *21, *reprinted in* 14 DEL. J. CORP. L. at 884.

245. *Restaurant Assocs. II*, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,617, at 97,888, *reprinted in* 16 DEL. J. CORP. L. at 1475.

246. *Restaurant Assocs. I*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,502, at 97,214, *reprinted in* 13 DEL. J. CORP. L. at 664.

247. *TWA*, No. 9844 (Consolidated), 1988 Del. Ch. LEXIS 139, at *21, *reprinted in* 14 DEL. J. CORP. L. at 884.

248. *Id.* at *21-22, *reprinted in* 14 DEL. J. CORP. L. at 884-85; *see also Restaurant*

III. CHANCELLOR ALLEN AND THE SHAREHOLDER'S RIGHT TO DECIDE

The cases discussed in Section II above illustrate Chancellor Allen's willingness, under appropriate circumstances, to defer to business decisions made by disinterested directors acting in good faith and on an informed basis, even where those business decisions involve contests for corporate control or controlling shareholder transactions. Chancellor Allen, however, has not hesitated to enjoin board conduct involving the deprivation of shareholder rights, even when adopted by directors *not* found by the Chancellor to have been interested or to have acted in bad faith or without due care.

Chancellor Allen's three most noteworthy decisions in this regard have been *AC Acquisitions Corp. v. Anderson, Clayton & Co.*,[249] *City Capital Associates v. Interco, Inc.*,[250] and *Blasius Industries, Inc. v. Atlas Corp.*[251] *Anderson, Clayton* and *Interco* involved determinations by disinterested directors, acting in good faith and with due care, that effectively blocked shareholders from determining for themselves whether they wished to tender their shares to a potential acquiror opposed by an incumbent board. These decisions, however, did not reach board determinations to use a poison pill shareholder rights plan to "just say no" to an all cash for all shares offer posing no threat to the corporation other than price inadequacy, under circumstances where no auction or alternative value-maximizing transaction was or would be proposed—an issue that has not yet been squarely decided by any court. *Blasius* dealt with board conduct that effectively blocked shareholders from determining for themselves whether they wished to vote an incumbent board out of office.

Assocs. II, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,617, at 97,882, *reprinted in* 16 DEL. J. CORP. L. at 1475:

> [I]n this instance, facts are alleged that would establish that this special committee was not given the opportunity to select from among the range of alternatives that an independent, disinterested board would have had available to it; it was, in effect, "hemmed in" by the management group's actions. Under these circumstances, where . . . the management group could (and did) veto any action of the special committee that was not agreeable to the conflicted interests of the management directors it would be formalistically perverse to afford the special committee's action the effect of burden shifting of which that device is capable.

249. 519 A.2d 103 (Del. Ch. 1986).

250. 551 A.2d 787 (Del. Ch. 1988).

251. 564 A.2d 651 (Del. Ch. 1988).

A. Anderson, Clayton *and* Interco: *The Tendering of Shares and the Shareholders' Right to Decide*

AC Acquisitions Corp. v. Anderson, Clayton & Co.[252] involved what Chancellor Allen described as a "front-end loaded"[253] $60 per share self-tender offer for 65.5% of Anderson, Clayton's stock, made in response to a concededly fair $56 per share all cash offer for all shares.[254] The economic effect of Anderson, Clayton's self-tender offer was to create a situation in which "no rational shareholder could afford not to tender into the Company's self-tender offer,"[255] since the value of Anderson, Clayton stock would be materially less than $60 per share (estimates presented to the court ranged from $22 to $52 per share) following consummation of the self-tender offer.[256] Chancellor Allen explained that as a result, a shareholder

> who elects not to tender into the self-tender is very likely . . . to experience a substantial loss in market value of his holdings. The only way . . . that a shareholder can protect himself from such an immediate financial loss is to tender into the self-tender so that he receives his *pro rata* share of the cash distribution that will, in part, cause the expected fall in the market price of the Company's stock.[257]

Applying the *Unocal Corp. v. Mesa Petroleum Co.*[258] standard of judicial review,[259] Chancellor Allen enjoined the self-tender offer on the ground that the board's decision to commence the offer satisfied *Unocal*'s first prong but not its second prong.[260] The Chancellor accepted the Anderson, Clayton Board's contention that the $56 all cash offer posed a "threat" to Anderson, Clayton's shareholders in the sense that a majority of shareholders might prefer an alternative permitting them "to have the benefits of a large, tax-advantaged cash distribution together with a continuing participation in a newly-structured, highly-leveraged Anderson, Clayton."[261] The Chancellor explained:

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252. 519 A.2d 103 (Del. Ch. 1986).
253. *Id.* at 114.
254. *Id.* at 112.
255. *Id.* at 113.
256. *Id.*
257. *Id.* at 113-14 (footnoted omitted).
258. 493 A.2d 946 (Del. 1985).
259. *See supra* notes 36-44 and accompanying text.
260. *Anderson, Clayton*, 519 A.2d at 112, 114.
261. *Id.* at 112.

> The Board recognizes that the [$56] offer—being for all shares and offering cash consideration that the Board's expert advisor could not call unfair—is one that a rational shareholder might prefer. However, the Board asserts—and it seems to me to be unquestionably correct in this—that a rational shareholder might prefer the Company Transaction. One's choice, if given an opportunity to effectively chose [sic], might be dictated by any number of factors most of which (such as liquidity preference, degree of aversion to risk, alternative investment opportunities and even desire or disinterest in seeing the continuation of a distinctive Anderson, Clayton identity) are distinctive functions of each individual decision-maker.[262]

Chancellor Allen concluded, however, that the self-tender offer failed to satisfy the second prong of the *Unocal* test, because "an Anderson, Clayton stockholder, acting with economic rationality, has no effective choice as between the contending offers as presently constituted."[263] The Chancellor explained that "[e]ven if a shareholder would prefer to sell all of his or her holdings at $56 per share, . . . he or she may not risk tendering into that proposal and thereby risk being frozen out of the front end of the Company Transaction, should the [$56] offer not close."[264] The Chancellor thus enjoined the transaction on the ground that the "coercive"[265] and "obvious entrenchment *effect*" of the self-tender offer transaction constituted "a breach of a duty of loyalty, albeit a possibly unintended one."[266]

City Capital Associates v. Interco, Inc.[267] involved the "end-stage"[268] of a takeover contest in which two alternative transactions were pending before Interco shareholders. The first alternative was a $74 per share all cash offer for all Interco shares by an unsolicited offeror that

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262. *Id.*
263. *Id.* at 114.
264. *Id.* (footnote omitted).
265. *Id.* at 113.
266. *Id.* at 114. Chancellor Allen noted his view that an alternative transaction such as the corporation's self-tender offer in *Anderson, Clayton* would be "manifestly reasonable" were it timed in a manner which would provide shareholders with a real choice between alternatives. The Chancellor suggested, for example, that a self-tender offer allowing shareholders to continue to own part of the corporation, but that would be available only following a decision by a majority of shareholders not to tender into a competing all cash tender offer, might well be permissible. *Id.*
267. 551 A.2d 787 (Del. Ch. 1988).
268. *Id.* at 790.

Interco's Board believed in good faith and on an informed basis was inadequate.[269] The second alternative was a board approved restructuring plan consisting of (1) the sale by Interco of assets (including Interco's Ethan Allen "crown jewel" division) generating approximately fifty percent of Interco's gross sales, (2) the borrowing of approximately $2 billion, (3) the declaration of a part-cash and part-securities dividend having an estimated aggregate value of $66 per share, and (4) shareholders retaining an equity interest, or "stub," which Interco's Board estimated would trade for at least $10 per share.[270] Chancellor Allen emphasized that Interco's Board believed in good faith and on an informed basis that the restructuring transaction was worth at least $76 per share, but that this was "inherently a debatable proposition" due to the nature of the securities involved.[271] The Chancellor also noted that the investment banking firm which had advised the board that the restructuring transaction had a $76 value had "a rather straightforward and conventional conflict of interest," since it would receive "substantial contingency pay" if the restructuring was successfully completed.[272]

Chancellor Allen held that the Interco Board's decision to protect the restructuring by precluding shareholder choice (and, thus, "save shareholders from the consequences of the choice they might make, if permitted to choose")[273] by way of a poison pill shareholder rights plan[274] was not a reasonable reaction to any threat faced by Interco

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269. *Id.* at 794-95.
270. *Id.* at 793-94.
271. *Id.* at 795.
272. *Id.* at 793.
273. *Id.* at 799.
274. A poison pill shareholder rights plan typically involves the issuance of "rights" that entitle their holders to purchase shares (or fractions of shares) of the corporation's common stock at a designated exercise price. The exercise price typically reflects the judgment of the corporation's board concerning the likely market value of the corporation's stock at the time of the plan's expiration (usually 5 to 10 years after the plan's adoption), and is therefore "out of the money," i.e., too high for anyone to consider using the rights to purchase stock. The most common rights plan utilized today contains both "flip in" and "flip over" provisions. Once any person or group acquires ownership of a specified level of the corporation's voting stock (typically something between 10 and 20%), rights holders other than the acquiring person or group may purchase for the exercise price common or preferred stock of the target corporation having twice the market value of the exercise price of the rights. If a merger or other business combination occurs between the corporation and an acquiror, then holders of rights (other than the acquiror) may purchase for the exercise price common stock of the surviving corporation (the target corporation or the acquiror, depending upon which entity survives the merger or other business

shareholders, and thus could not "be justified in the way *Unocal* requires."[275] The Chancellor explained that a board determination that an offer is inadequate (but not coercive) justifies 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 . . . ."[276] This "may entail negotiation on behalf of shareholders with the offeror, the institution of a *Revlon*-style auction for the Company, a recapitalization or restructuring designed as an alternative to the offer, or other action."[277] Once, however, this period ends "and it is apparent that the board does not intend to institute a *Revlon*-style auction, or to negotiate for an increase in the unwanted offer, and that [the board] has taken such time as it required in good faith to arrange an alternative value-maximizing transaction," the legitimate role of the poison pill in the context of a noncoercive offer is completely fulfilled, according to Chancellor Allen.[278] Shareholders, according to the Chancellor, must then be allowed to exercise their own judgment about their own interests.[279]

The Chancellor concluded that it was "inarguable" in this case that "a shareholder could prefer a $74 cash payment now to the complex future consideration offered through the restructuring,"[280] and ordered Interco to redeem its poison pill rights plan or keep the plan in place solely for the purpose of conducting a two week auction.[281] The Chancellor stayed his Order in order to preserve the status quo pending an appeal by Interco to the Delaware Supreme Court,[282] but the $74 per share tender offer was withdrawn a short time later and the appeal was dismissed on mootness grounds.[283]

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combination) having twice the market value of the exercise price. The rights holders thus "flip in" their rights and purchase stock of the target corporation if the triggering percentage of shares is acquired or if the target corporation is the surviving entity in a business combination, and "flip over" their rights and purchase stock of the acquiror if it is the surviving entity in a business combination.

275. *Interco*, 551 A.2d at 800.

276. *Id.* at 798.

277. *Id.* (footnote omitted).

278. *Id.* (footnote omitted).

279. *Id.*

280. *Id.* at 799.

281. City Capital Assocs. v. Interco, Inc., No. 10,105, Order at 1-2 (Del. Ch. Nov. 3, 1988).

282. *Id.*, slip op. at 2-3.

283. Interco, Inc. v. City Capital Assocs., 556 A.2d 1070 (Del. 1988); *Appeal Moot in Interco Case*, N.Y. Times, Nov. 19, 1988, at 34; Michael Quint, *Withdrawal*

Chancellor Allen's decision four months later in *TW Services, Inc. v. SWT Acquisition Corp.*[284] limited *Interco*'s reach to a board decision "to pursue a defensive restructuring that in form and effect was (so far as the corporation itself was concerned) a close approximation of and an alternative to a pending all cash tender offer for all shares."[285] *TW* involved a $29 per share all cash offer for all TW shares by a nineteen percent shareholder conditioned upon redemption by TW's Board of the corporation's poison pill rights plan and the signing by the board of a merger agreement.[286] The $29 price represented an approximately fifty percent premium over TW's pre-offer market price, and was supported by the tender of approximately eighty-five percent of the TW shares not already held by the offeror.[287] The TW Board, which was advised by its financial advisors that the $29 price was inadequate, contended in good faith that the offer was "merely an invitation to negotiate"[288] and not a "real"[289] offer, and refused to consider redemption of the poison pill rights plan.[290]

Chancellor Allen determined that there was no need in the *TW* litigation to resolve whether the TW Board had "breached a duty owed to the corporation and its shareholders in concluding that they are not required, under the present circumstances, to consider whether or not to place the corporation in a current share value maximizing mode"[291] because the offeror had not merely commenced a tender offer, but had conditioned the tender offer upon the acceptance of a merger proposal.[292] The merger proposal, the Chancellor explained, called upon TW's Board to act under section 251 of the Delaware General Corporation Law, a provision requiring board approval before a merger proposal can be presented to shareholders,[293] and thus im-

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of Interco Bid Is Pursued, N.Y. Times, Nov. 17, 1988, at D4. For subsequent proceedings involving breach of fiduciary duty allegations against Interco's directors in connection with Interco's restructuring and ultimate bankruptcy, see Report of Examiner Sandra E. Mayerson, *In re* Interco Inc., No. 91-4-00442-172 (E.D. Mo. filed Oct. 23, 1991).

284. [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).

285. *Id.* at 92,181, *reprinted in* 14 DEL. J. CORP. L. at 1188.

286. *Id.* at 92,176-77, *reprinted in* 14 DEL. J. CORP. L. at 1173.

287. *Id.* at 92,174, *reprinted in* 14 DEL. J. CORP. L. at 1175.

288. *Id.* at 92,176-77, *reprinted in* 14 DEL. J. CORP. L. at 1179.

289. *Id.* at 92,176-77, *reprinted in* 14 DEL. J. CORP. L. at 1180.

290. *Id.* at 92,181, *reprinted in* 14 DEL. J. CORP. L. at 1180.

291. *Id.* at 92,181, *reprinted in* 14 DEL. J. CORP. L. at 1189.

292. *Id.* at 92,181-82, *reprinted in* 14 DEL. J. CORP. L. at 1178.

293. DEL. GEN. CORP. L. § 251.

plicated different judicial treatment of the directors' role with respect to the transaction than would otherwise have been the case.[294]

According to Chancellor Allen, a decision to preclude a hostile tender offer (by use of a poison pill or any other means) is a defensive measure subject to the standard of review set forth in *Unocal*, but a decision not to pursue a statutory merger is not a defensive measure and is not subject to the *Unocal* standard of review.[295] The Chancellor therefore tested the board's decision not to approve a merger pursuant to ordinary business judgment rule principles, and concluded that disinterested and independent directors acting in good faith and with due care had determined that the proposed merger would not serve the corporation's best interests due to the high level of debt that would be owed by the corporation following the merger.[296]

In sum, Chancellor Allen distinguished *Interco*, in *TW*, on the ground that in *Interco* "it was thought that the central purpose of a pill—to give a board time to negotiate on shareholders' behalf or to consider alternatives to a tender offer or street sweep[297] that threatened to coerce or otherwise injure shareholders—had been fully served."[298] *TW*, by contrast, involved a merger proposal not subject to a *Unocal* analysis, and "circumstances in which a board had in good faith . . . elected to continue managing the enterprise in a long term mode and not to actively consider an extraordinary transaction of any type."[299]

Chancellor Allen's 1986 and 1988 decisions in *Anderson, Clayton* and *Interco*, respectively, must be read not only in light of Chancellor Allen's 1989 decision in *TW*, but also in light of the Delaware Supreme Court's 1990 decision in *Paramount Communications, Inc. v. Time Inc.*[300] The Supreme Court's decision in *Time*, which upholds Chancellor Allen's earlier decision in that case,[301] identifies *Anderson, Clayton* and

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294. *TW*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,181-82, *reprinted in* 14 DEL. J. CORP. L. at 1189.

295. *Id.* at 92,182, *reprinted in* 14 DEL. J. CORP. L. at 1190.

296. *Id.* at 92,182, *reprinted in* 14 DEL. J. CORP. L. at 1191.

297. A "street sweep" is a "rapid acquisition of securities on the open market," with "[t]he shares . . . ordinarily purchased at a premium from arbitrageurs." Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1337 n.3 (Del. 1987).

298. *TW*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,182, *reprinted in* 14 DEL. J. CORP. L. at 1188.

299. *Id.*

300. 571 A.2d 1140 (Del. 1989).

301. 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), *aff'd*, 571 A.2d 1140 (Del. 1990); *see supra* notes 104-37 and accompanying text (discussing Chancellor Allen's *Time* opinion).

Interco (and *Grand Metropolitan, PLC v. Pillsbury Co.*,[302] a 1988 decision by retired Supreme Court Justice William Duffy, sitting in the court of chancery by designation),[303] as decisions in which "the Court of Chancery has suggested that an all-cash, all-shares offer, falling within a range of values that a shareholder might reasonably prefer, cannot constitute a legally recognized 'threat' to shareholder interests sufficient to withstand a *Unocal* analysis."[304]

With regard to the first prong of the *Unocal* analysis—i.e., "reasonable grounds for believing that a danger to corporate policy and effectiveness existed"[305]—the supreme court in *Time* stated that "substituting" the court's "judgment as to what is a 'better' deal for that of a corporation's board of directors" constitutes "a fundamental misconception of our standard of review under *Unocal*."[306] Accordingly, the supreme court in *Time* concluded that "[t]o the extent that the Court of Chancery has recently done so in certain of its opinions, we

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302. 558 A.2d 1049 (Del. Ch. 1988).

303. *Id.* at 1050. *Pillsbury* involved a $63 per share all cash offer (representing a 60% premium over Pillsbury's pre-offer market price) by Grand Metropolitan for all shares of The Pillsbury Company, conditioned upon Pillsbury's redemption of its poison pill. *Id.* at 1052. Pillsbury's Board, acting in good faith, responded to Grand Metropolitan's offer with a restructuring plan that Pillsbury contended would provide $68 in long-term value for shareholders by spinning off and selling various Pillsbury businesses over a two and one-half to five year period. *Id.* at 1057. The "bottom line in Pillsbury's plan," the court observed, "is that, on a per share basis, the present minimum value (according to [Pillsbury's] experts) is $68—and to realize that, a shareholder will have to be patient and endure for a long time . . . ." *Id.* The court added that "Pillsbury's corporate performance must improve substantially in the future if it is to earn and receive . . . the premiums that are the predicate for its optimistic forecasts," and that "[i]n all events, expectancies over a four or five year period . . . are subject to economic and competitive conditions which are beyond Pillsbury's control." *Id.*

Noting that "I agree with the Chancellor's analysis in *Interco*," *id.* at 1060, the court ordered Pillsbury to redeem its rights plan. The court stated that Pillsbury's use of the plan to preclude shareholders—87% of whom had tendered their shares—from concluding that "$63 in present cash is preferable to the possibility of $68 if all of the 'ifs' in Pillsbury's plan disappear and it hopes for the future become realities" was far out of proportion to the minimal threat (relating solely to the price Pillsbury shareholders would receive for their stock) posed by Grand Metropolitan's $63 per share offer. *Id.* at 1057. The court emphasized its view that the real threat to shareholder value was not the difference between $63 and $68, but rather the difference between $63 and a price in the high $30s, where the court believed the stock would likely fall if Grand Metropolitan's offer failed. *Id.* at 1058.

304. *Time*, 571 A.2d at 1152.

305. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985); *see supra* notes 36-44 and accompanying text (discussing the two-part *Unocal* analysis).

306. *Time*, 571 A.2d at 1153.

hereby reject such approach as not in keeping with a proper *Unocal* analysis."[307] The supreme court followed this statement with a citation to "*Interco* . . . and its progeny."[308]

With regard to the second prong of the *Unocal* analysis—i.e., whether the defensive measure decided upon was "reasonable in relation to the threat posed"[309]—the supreme court in *Time* stated that "even in light of a valid threat, management actions that are coercive in nature or force upon shareholders a management-sponsored alternative to a hostile offer may be struck down as unreasonable and non-proportionate responses," and cited *Anderson, Clayton* as an example of an unreasonable and non-proportionate response.[310]

The Delaware Supreme Court's opinion in *Time* concluded that the Time Board's conduct did not constitute such an unreasonable and non-proportionate response, since Time's response to the unwanted tender offer in that case "was not aimed at 'cramming down' on its shareholders a management-sponsored alternative, but rather had as its goal the carrying forward of a pre-existing transaction in an altered form."[311] The supreme court, however, did not define the point at which a responsive board action reaches the level of "cramming down" on shareholders a management-sponsored alternative to an outsider's bid for control, nor whether the board conduct in *Interco*, like the board conduct in *Anderson, Clayton*, had "cramm[ed] down" a management sponsored alternative upon shareholders to an outsider's bid for control. Neither the supreme court in *Time*, Chancellor Allen, nor any other judge has decided whether a board determination to use a poison pill rights plan to block an all cash for all shares offer is a breach of fiduciary duty, where the offer poses no threat to the corporation except price inadequacy, and where no auction or alternative value-maximizing transaction has been or will be proposed.[312]

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307. *Id.*

308. *Id.* Immediately after the citation to "*Interco* . . . and its progeny" is a citation reading "*but see* TW Services, Inc. v. SWT Acquisition Corp." *Id.*

309. *Unocal*, 493 A.2d at 955.

310. *Time*, 571 A.2d at 1154.

311. *Id.* at 1154-55; *see supra* notes 104-37 and accompanying text (discussing the *Time* case).

312. Chancellor Allen's decision in *Time*, which upheld a board decision to reject an unsolicited offer in favor of pursuing a long-term strategic plan (*see supra* notes 104-37 and accompanying text), noted that the case did not involve a decision not to redeem a poison pill rights plan, "which by definition is a control mechanism and not a device with independent business purposes," and that a case involving the poison pill redemption issue "may present distinctive considerations." Paramount

B. *Blasius: The Voting of Shares and the Shareholders' Right to Decide*

Chancellor Allen's 1988 decision in *Blasius Industries, Inc. v. Atlas Corp.*[313] involved a consent solicitation by a nine percent shareholder who had proposed a leveraged restructuring in order to facilitate a cash distribution to shareholders.[314] The nine percent shareholder was also seeking to expand the size of the corporation's board from seven to fifteen members (the maximum number authorized in the corpor-

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Communications Inc. v. Time Inc., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,264, 93,283-84 & n.22 (Del. Ch. July 14, 1989) (Revised July 17, 1989), *reprinted in* 15 DEL. J. CORP. L. 700, 749 & n.22 (1990).

The closest any court has come to deciding this issue in the context of a poison pill rights plan was in Amanda Acquisition Corp. v. Universal Foods Corp., 708 F. Supp. 984 (E.D. Wis.), *aff'd on other grounds*, 877 F.2d 496 (7th Cir.), *cert. denied*, 493 U.S. 955 (1989). *Universal Foods* involved a $35 per share all cash offer by Amanda Acquiring Corporation for all shares of Universal Foods Corporation. *Id.* at 989. Construing Wisconsin law in accordance with Delaware law, the court upheld the Universal Board's refusal to redeem the corporation's poison pill as a reasonable response to various threats posed by the Amanda tender offer. The court identified these threats as (1) the Universal Foods Board's determination that Amanda's offer was inadequate, (2) the possibility that Amanda's offering materials might contain false or materially misleading information regarding the roles of certain of Amanda's principals and the offer's "extremely complex, if not convoluted" financing that "lack[ed] the detail one would reasonably expect to find in transactions of this nature," and (3) the danger posed to the corporation's non-shareholder constituencies (including customers, suppliers and employees) and the corporation itself by the highly leveraged nature of Amanda's tender offer. *Id.* at 1014-15. The court, in dictum, stated its belief that a board may not

> [i]n all instances preclude shareholder choice solely on the basis of its own perception of the inadequacy of the offer. If no other threat is posed to the corporation and shareholders, a board must at some point allow shareholders to choose between the offer and some alternative. Whether the alternative is to remain independent and reap the future benefits with the company, as the board proposes here, or a financial restructuring . . . , or an auction of the company . . . , the shareholders must at some point be allowed to choose. To do otherwise is to disenfranchise the shareholders.

Id. at 1014-15. Retired Delaware Supreme Court Justice William Duffy, sitting on the court of chancery by designation in Grand Metro., PLC v. Pillsbury Co., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,096, at 91,159 (Del. Ch. Nov. 7, 1988) (Revised Nov. 9, 1988), *reprinted in* 14 DEL. J. CORP. L. 1042 (1989), observed in language similar to the district court in *Universal Foods* that a corporation's "exploration of alternatives may go on indefinitely, but a 'just say no' posture may not justify keeping a Pill in place when its only purpose is to bar all stockholders from having an opportunity to consider an all-cash, all-shares offer to sell their shares." *Id.* at 91,160, *reprinted in* 14 DEL. J. CORP. L. at 1044. A later decision in the *Pillsbury* litigation, Grand Metro., PLC v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988), is discussed above. *See supra* note 303.

313. 564 A.2d 651 (Del. Ch. 1988).

314. *Id.* at 654.

ation's charter) and to elect eight directors to fill the newly created vacancies.[315] The board responded by adopting a bylaw amendment enlarging the board's size to nine and appointing two new directors.[316] This ensured that the nine percent shareholder would not gain control of the board, even if it gained the support of the holders of a majority of the corporation's shares and filled the six board vacancies that would then exist.[317] Chancellor Allen found that the board "was not selfishly motivated simply to retain power,"[318] and that it acted "in a good faith effort to protect its incumbency, not selfishly, but in order to thwart implementation of the recapitalization that it feared, reasonably, would cause great injury to the Company."[319]

Chancellor Allen nevertheless set aside the board's expansion of its size as "an unintended breach of the duty of loyalty."[320] The Chancellor declined to adopt "a *per se* rule invalidating, in equity, every board action taken for the sole or primary purpose of thwarting a shareholder vote," since "[i]t may be that some set of facts would justify such extreme action,"[321] but concluded that the board in *Blasius* could not meet "the heavy burden of demonstrating a compelling justification for such action":[322]

> The board was not faced with a coercive action taken by a powerful shareholder against the interests of a distinct shareholder constituency (such as a public minority). It was presented with a consent solicitation by a 9% shareholder. Moreover, here it had time (and understood that it had time) to inform the shareholders of its views on the merits of the proposal subject to stockholder vote. The only justification that can, in such a situation, be offered for the action taken is that the board knows better than do the shareholders what is in the corporation's best interest. While that premise is no doubt true for any number of matters, it is irrelevant (except insofar as the shareholders wish to be guided by the board's recommendation) when the question is who should comprise the board of directors. The theory of our corpo-

315. *Id.*
316. *Id.* at 654-55.
317. *Id.* at 654-55.
318. *Id.* at 656.
319. *Id.* at 658.
320. *Id.* at 663.
321. *Id.* at 662 (footnote omitted).
322. *Id.* at 661.

> ration law confers power upon directors as the agents of the shareholders; it does not create Platonic masters.[323]

The Chancellor emphasized that the "Delaware courts have long exercised a most sensitive and protective regard for the free and effective exercise of voting rights,"[324] and that "the ordinary considerations to which the business judgment rule originally responded are simply not present in the shareholder voting context."[325]

Articles were written shortly following Chancellor Allen's decision in *Blasius* suggesting that *Blasius* was "likely to have a major impact on the development of Delaware takeover law,"[326] but subsequent decisions by the Chancellor, most notably, *Gintel v. XTRA Corp.*[327] and *Stahl v. Apple Bancorp., Inc.*,[328] have read *Blasius* narrowly.

In the *XTRA* case, a board decision was made two days before an annual meeting, at which shareholders were scheduled to vote in a hotly contested election, to delay the meeting for thirty days in order to provide the board an opportunity to arrange a sale of the

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323. *Id.* at 662-63.

324. *Id.* at 659 n.2.

325. *Id.* at 659 (footnote omitted); *see also* Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp., No. 12,150, 1991 Del. Ch. LEXIS 215, at *109 n.56 (Del. Ch. Dec. 30, 1991), *reprinted in* 17 DEL. J. CORP. L. 1156 n.56 (1992) [17-3] (citing *Blasius* for the proposition that board action intended to impede stockholder exercise of statutory franchise right is suspect even if taken in good faith effort to promote corporate welfare); Sutton Holding Corp. v. DeSoto, Inc., [1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,012, at 90,063, 90,064 (Del. Ch. May 14, 1991), *reprinted in* 17 DEL. J. CORP. L. 363, 366 (1992) (noting that under *Blasius*, "[p]rovisions in corporate instruments that are intended principally to restrain or coerce the free exercise of the stockholder franchise are deeply suspect," and assuming but not holding that provisions barring any amendment to a corporation's existing pension plans for a period of five years following a change in control constituted a breach of the duty of loyalty, because "[w]hen the . . . board injected this provision in the company's pension plans, its dominant motivation was doubtlessly not to create a valuable economic right in plan beneficiaries," but rather to deter a change in control).

326. Michael D. Goldman & Stephen C. Norman, *Blasius Case Adopts a Tougher Standard for Board Actions*, Nat'l L.J., Feb. 5, 1990, at S15, col. 1; *see also* Thomas J. Andre, Jr., *A Preliminary Inquiry into the Utility of Vote Buying in the Market for Corporate Control*, 63 S. CAL. L. REV. 533, 570 n.152 (1990) (describing *Blasius* as being "[p]erhaps [the] most prominent among the recent cases"); 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, 641 (1991) (citing same language quoted *supra* from Goldman & Norman article).

327. No. 11,422 (Del. Ch. Feb. 27, 1990).

328. 579 A.2d 1115 (Del. Ch. 1990) (*Stahl I*), *subsequent proceedings*, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,412, at 97,031 (Del. Ch. Aug. 9, 1990) (*Stahl II*), *reprinted in* 16 DEL. J. CORP. L. 1573 (1991).

company. Chancellor Allen rejected *Blasius* as a controlling authority, since the board's action in *Blasius* "absolutely precluded the effectiveness of a shareholder vote," whereas in *XTRA* the board action simply "put the meeting off for 30 days . . . and importantly, the same record date was preserved, so that the proxies now in hand will be effective except in the case of a shareholder that chooses to change his, her or its mind."[329]

Rather than applying the *Blasius* "compelling justification" standard, Chancellor Allen noted in *XTRA* that there were two perspectives from which proxy contests could be viewed: (1) "fairness or unfairness as between the two contending groups of candidates for office," and (2) "the interests of the shareholders and the effective exercise of the franchise."[330] Balancing the interests underlying these two perspectives, the Chancellor ordered that the meeting be held within fifteen days, "in order to make known to all the shareholders that a significant development had occurred; *i.e.*, [the board's] decision to seek to pursue an extraordinary transaction of some kind."[331] The Chancellor refused, however, to allow the incumbent board time to effectuate its plan to arrange a sale of the company because the plan had been developed "on almost the virtual eve of a meeting at which there is every reason to understand that there is a substantial question as to the stockholders' designation of the members of this board to continue" in office.[332]

Stahl v. Apple Bancorp, Inc.[333] involved a board decision, made in response to an announced tender offer and proxy contest by a thirty percent shareholder, to withdraw an already set record date and defer an annual meeting planned for May 1990 until after the corporation could "explore the advisability of pursuing an extraordinary transaction . . . ."[334]

The thirty percent shareholder whose conduct provided the impetus for the board's action was seeking (1) to purchase all outstanding shares of the corporation's stock at a seventeen percent premium over the stock's pre-offer market price, and (2) to expand the size of the board from twelve directors to twenty-one directors (the company's

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329. *XTRA*, No. 11,422, slip op. at 4.

330. *Id.*, slip op. at 2-3.

331. *Id.*, slip op. at 5.

332. *Id.*, slip op. at 7-8.

333. 579 A.2d 1115 (Del. Ch. 1990) (*Stahl I*), *subsequent proceedings*, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,412, at 97,031 (Del. Ch. Aug. 9, 1990) (*Stahl II*), *reprinted in* 16 DEL. J. CORP. L. 1573 (1991).

334. *Id.* at 1117.

twelve director board was a "staggered" board on which only four directors were required to seek re-election each year, thus necessitating that a dissident shareholder seeking to gain majority control of the company's board in a single year first had to increase the size of the board).[335] At the time of the board's decision to postpone its annual meeting, no specific date had been set for the meeting, and no proxy materials had been sent by the corporation to shareholders.[336] The board, however, had been advised by the company's proxy solicitor that the thirty percent shareholder would likely prevail in a proxy fight if the board did not present shareholders with an economic alternative to the thirty percent shareholder's bid.[337] The thirty percent shareholder filed suit seeking to require the board to hold the corporation's annual meeting by mid-June.[338]

Chancellor Allen held that the fundamental question to be determined in evaluating directorial conduct involving the shareholder franchise is "whether the directors' purpose is 'inequitable,'"[339] an inquiry requiring the court "to ask, in the context of this case, whether [the directors] have taken action for the purpose of impairing or impeding the effective exercise of the corporate franchise and, if they have, whether . . . special circumstances are present . . . warranting such an unusual step."[340] Such "special circumstances," Chancellor Allen explained, must provide a "compelling justification" for board interference with the "high value" the Delaware courts have traditionally placed upon the exercise of voting rights.[341]

Chancellor Allen found no need to "inquire into the question of justification" in this case, however, because he could not conclude, as he had in *Blasius*, that the board's determination to change its plan to hold the corporation's annual meeting in May was made "for the primary purpose of impairing or impeding the effective exercise of the corporate franchise."[342] The Chancellor carefully premised his ruling "on the narrow ground that the action of deferring this company's annual meeting where no meeting date has yet been set and no proxies even solicited does not impair or impede the effective

335. *Id.* at 1119 n.3.
336. *Id.* at 1119.
337. *Id.* at 1118.
338. *Id.* at 1117.
339. *Id.* at 1121.
340. *Id.* at 1122.
341. *Id.*
342. *Id.*

exercise of the franchise to any extent."[343] The Chancellor emphasized that the election process will go forward at a time consistent with the company's bylaws and section 211 of the Delaware General Corporation Law, which grants the court of chancery authority to order a shareholder meeting if no meeting has been held either within thirty days of the date designated by the corporation's board for a meeting or for a period of thirteen months following the corporation's last annual meeting.[344] The Chancellor acknowledged that "postponement of a noticed meeting will in some circumstances constitute an inequitable manipulation" of the corporate franchise, but concluded that the franchise process cannot "be said to be sufficiently engaged before the fixing of this meeting date to give rise to that possibility."[345]

Chancellor Allen then tested the board's conduct pursuant to the *Unocal Corp. v. Mesa Petroleum Co.*[346] rule,[347] and held that where a proxy contest is tied to a tender offer and shareholders are "in effect . . . asked to decide whether the company should be sold," the absence of relevant information which "disaggregated shareholders are incapable of obtaining" without board involvement "may reasonably be seen as posing a threat" to the vote.[348] Having thus identified a threat, the Chancellor upheld the board's "extremely mild" response to this threat—delay of a not yet called annual meeting to a later date, consistent with the company's bylaws and Delaware's General Corporation Law. The Chancellor noted that "[t]o delay a meeting once called would constitute a more substantial question of disproportionality,"[349] and that "[a]s one moves closer to a meeting date . . . , attempts to postpone a meeting would likely require a greater and greater showing of threat in order to justify interfering with the conclusion of an election contest."[350]

In a second *Stahl* decision issued three months later,[351] Chancellor Allen again construed *Blasius* narrowly, this time in the context of a poison pill shareholder rights plan defining the term "shareholder"

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343. *Id.* at 1123.
344. *Id.*; *see* DEL. GEN. CORP. L. § 211.
345. *Stahl I*, 579 A.2d at 1123.
346. 493 A.2d 946 (Del. 1985).
347. *See supra* notes 36-44 and accompanying text.
348. *Stahl*, 579 A.2d at 1124.
349. *Id.*
350. *Id.*
351. *Stahl v. Apple Bancorp, Inc.*, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,412, at 97,031 (Del. Ch. Aug. 9, 1990) (*Stahl II*), *reprinted in* 16 DEL. J. CORP. L. 1573 (1991).

in a manner that would preclude the corporation's thirty percent shareholder from entering into an agreement, arrangement or understanding

> with other shareholders (if those shareholders own .7% of Bancorp's stock) to serve on the same slate of directors in opposition to the management slate; from agreeing to indemnify (or be indemnified by) other shareholders in connection with running for office; and from asking for and receiving permission to use the name of another stockholder for purposes of endorsing his slate, even if there were no irrevocable proxy given or other promises made.[352]

Upholding the board's refusal to redeem the rights or to amend the plan's beneficial ownership definition in order to facilitate "agreements, arrangements or understandings" between the thirty percent shareholder and other shareholders, Chancellor Allen rejected *Blasius* as the governing standard on the ground that the *Blasius* approach "is appropriate when board action appears directed primarily towards interfering with the fair exercise of the franchise (*e.g.*, moving a meeting date; adopting a bylaw regulating shareholder voting, etc.)."[353] The rights plan at issue here, the Chancellor stated, "may or may not have that effect, but it does not represent action taken for the primary purpose of interfering with the exercise of the shareholders' right to elect directors."[354]

Applying *Unocal*, the Chancellor explained that the board was searching for an alternative transaction, and accepted the reasonableness of the board's belief that this search was likely to be disadvantaged by anything enhancing the public perception that the thirty percent shareholder was likely to prevail in the proxy contest.[355] The court explained the board's view that the existence of the thirty percent shareholder "itself create[d] a disincentive for other bidders to invest the time and resources necessary to bring a competing proposal forward," and that if the thirty percent shareholder was "able to reach agreements with other shareholders (such as agreements to run on the same slate), [then] this disincentive [would] be increased."[356]

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352. *Id.* at 97,033-34, *reprinted in* 16 DEL. J. CORP. L. at 1580-81.
353. *Id.* at 97,036, *reprinted in* 16 DEL. J. CORP. L. at 1587.
354. *Id.* at 97,036-37, *reprinted in* 16 DEL. J. CORP. L. at 1587.
355. *Id.* at 97,037, *reprinted in* 16 DEL. J. CORP. L. at 1587.
356. *Id.* at 97,034, *reprinted in* 16 DEL. J. CORP. L. at 1581.

The Chancellor also emphasized that "[s]hould the board fail to develop an attractive alternative, experience suggests that it is quite likely" that the thirty percent shareholder's position "will be accepted by a substantial majority of shareholders in the proxy context."[357] Accordingly, the Chancellor observed that "whatever small impact the present issue is likely to have, one way or the other, it will most importantly be upon the possible emergence of an alternative and not on the outcome of the contest, if no alternative is produced."[358] Thus, the Chancellor concluded:

> [C]onsidering his stock position, his cash offer and the other circumstances, . . . the impact of effectively precluding [the thirty percent shareholder] from forming a joint slate with other shareholders or otherwise entering into revocable agreements with them concerning the voting of stock is likely to have a "minimal" impact upon his proxy campaign (except insofar as it might marginally protect and preserve the board's opportunity to locate a better proposal).[359]

The Chancellor added that this "minimal impact" was justified "by the benefit of preserving to some extent the board's ability to shop the bank in the interim before the next annual meeting," and accordingly held that "the position of the board to leave in place and enforce the beneficial ownership term of the stock rights plan is reasonable in relation to the threat posed by the [thirty percent shareholder's] offer at this time."[360]

Paramount Communications, Inc. v. Time Inc.[361] and *Lennane v. ASK Computer Systems, Inc.*[362] provide two additional narrow readings of *Blasius* by Chancellor Allen. In *Time*, a case discussed in earlier sections of this article,[363] Chancellor Allen held that the *Blasius* rule did not control a board resolution (1) rescinding approval of a merger agree-

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357. *Id.*

358. *Id.* at 97,037, *reprinted in* 16 DEL. J. CORP. L. at 1587-88.

359. *Id.* at 97,037, *reprinted in* 16 DEL. J. CORP. L. at 1588.

360. *Id.*

361. [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), *aff'd*, 571 A.2d 1140 (Del. 1990).

362. [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,674, at 98,149 (Del. Ch. Oct. 11, 1990), *reprinted in* 16 DEL. J. CORP. L. 1521 (1991), *modified on reargument*, No. 11,744, 1990 Del. Ch. LEXIS 168 (Del. Ch. Oct. 19, 1990), *reprinted in* 16 DEL. J. CORP. L. 1538 (1991).

363. *See supra* notes 104-37 and 300-12 and accompanying text.

ment and removing a shareholder vote on a merger agreement from the agenda of a previously scheduled shareholder meeting, and (2) accomplishing the same business combination by commencing a friendly tender offer.[364] The Chancellor explained that *Blasius* involved shareholders "in the process of exercising statutorily conferred rights to elect directors through the consent process," and that

> I am aware of no principle, statute or rule of corporation law that would hold that once a board approves an agreement of merger, it loses power to reconsider that action prior to a shareholder vote. Equally fundamentally, Delaware law creates no power in shareholders to authorize a merger without the prior affirmative action of the board of directors.[365]

The *ASK* case involved a shareholder claim that a board's failure to obtain shareholder approval for an issuance of shares, amounting to thirty percent of the corporation's post-issuance stock, violated third party beneficiary rights possessed by shareholders arising out of a listing agreement the corporation had signed with the National Association of Securities Dealers/National Market System.[366] The shareholder alleged that the listing agreement provided that the corporation would lose its NASDAQ/NMS listing in the event of a stock issuance of twenty-five percent of the corporation's stock without a shareholder vote.[367] Denying preliminary injunctive relief, Chancellor Allen rejected *Blasius* as a controlling authority, explaining as follows:

> [T]he risk here of shareholder veto does not arise from a vote mandated by statute or charter. It arises from a third party contract. Thus, in my opinion, the risk that a shareholder vote may entail to the closing of the [challenged] transaction is not a risk—like the one encountered in *Blasius*—that the directors' duty of loyalty requires them to permit to occur. In this situation, the corporation statutes allocate to the board of directors the responsibility to decide. . . . The claim to a right to vote arises only from a contract that the board has the legal power to terminate. When the cor-

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364. *Time*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,282, *reprinted in* 15 DEL. J. CORP. L. at 743.

365. *Id.*

366. *Lennane*, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,674, at 98,149-52, *reprinted in* 16 DEL. J. CORP. L. at 1525-31.

367. *Id.*

> poration law statute, the certificate of [in]corporation or the company's by-laws creates a right to vote on a matter, loyalty to shareholders will ordinarily require directors to establish a compelling justification for action that significantly impairs that right. In those circumstances, the right to vote is constitutional, in the sense that the documents constituting the corporation and empowering directors to act provide for that vote. Directors are bound to accord great deference and respect to the shareholder vote as provided in the corporation's constitutional documents. A right to vote that arises only from director action is not constitutional in this sense, and with respect to such right, directors are bound simply to exercise their business judgment in an effort to promote the welfare of the corporation and the shareholders derivatively. Therefore, a vote of that type where it reasonably may be seen as endangering the accomplishment of a transaction that directors in good faith believe is in the corporation's best interest, may present a threat against which directors may act without breaching faith with shareholders. Directors are not required in all instances to follow shareholder views of advantageous corporate action.[368]

The Delaware Supreme Court addressed *Blasius* for the first time in 1992 in *Stroud v. Grace*[369] and stated that "we accept the basic legal tenets" of *Blasius* since "where boards of directors deliberately employ[ ] . . . legal strategies either to frustrate or completely disenfranchise a shareholder vote, . . . [t]here can be no dispute that such conduct violates Delaware law."[370] The supreme court in *Stroud* concluded that a *Blasius* analysis was inappropriate in the case before it, however, because the case involved the adoption of charter and bylaw amendments by a board controlled by three shareholders, and it could not be said "that the 'primary purpose' of the board's action was to interfere with or impede exercise of the shareholder franchise," since the board's action did not interfere with the right of the corporation's controlling shareholders to vote on corporate matters.[371] Moreover, the court stated, the actions of the board had been ratified by a vote

368. *Id.* at 98,154-55, *reprinted in* 16 DEL. J. CORP. L. at 1536-37 (citation omitted).

369. 606 A.2d 75 (Del. 1992).

370. *Id.* at 91.

371. *Id.* at 92.

of a fully informed majority of the corporation's shareholders, and thus "the factual predicate of unilateral board action intended to inequitably manipulate the corporate machinery is completely absent here."[372] Thus, unlike the shareholders in *Blasius*, the shareholders in *Stroud* "had a full and fair opportunity to vote on the Amendments and did so. The result of the vote, ceding greater authority to the board, does not under the circumstances implicate . . . *Blasius*."[373]

The supreme court in *Stroud* noted that board action during a hostile contest for corporate control where a potential acquiror commences a proxy contest is governed by *Unocal*, but that a court in this context "must recognize the special import of protecting the shareholders' franchise within *Unocal*'s requirement that any defensive measure be proportionate and 'reasonable in relation to the threat posed.'"[374] Pursuant to these principles, the *Stroud* court explained, "[a] board's unilateral decision to adopt a defensive measure touching 'upon issues of control' that purposefully disenfranchises its shareholders is strongly suspect under *Unocal*, and cannot be sustained without a 'compelling justification.'"[375]

While *Stroud* thus confirms the importance of the principles stated by Chancellor Allen in *Blasius*, the precise reach of *Blasius* is certain to be the subject of more litigation in coming months and years.

IV. CONCLUSION

Directors, corporate counselors, and the courts—both in and out of Delaware—will continue to struggle in the 1990s, although not with the same intensity as in the 1980s, with cases involving the relationship between the right and duty of directors to manage the business and affairs of corporations and the right of shareholders to tender or vote their stock as they see fit during a contest for corporate control. Chancellor Allen is only slightly more than mid-way through his

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372. *Id.*

373. *Id.*

374. *Id.* at 92 n.3.

375. *Id.*; *see also* Gregory v. Correction Connection, Inc., No. 88-7990, 1991 U.S. Dist. LEXIS 3659, at *60-61 (E.D. Pa. Mar. 27, 1991) (citations omitted):

> [A] *Unocal*-like, two-pronged threshold judicial inquiry will be performed whenever a challenged board action interferes with a shareholder's voting rights and affects control. To satisfy the first prong, directors must show that they acted pursuant to a proper and compelling corporate purpose. To satisfy the second prong, directors must make a strong showing of logical relation and of proportionality—stronger even than the showing that is required in traditional *Unocal* cases.

current twelve year term as chancellor and will no doubt continue to play a leading role in the "struggle to fashion answers"[376] to the difficult corporate governance questions discussed in this article, as well as the new questions that will be litigated in the 1990s involving the evolving relationship between corporate managers, outside directors and institutional shareholders, and the fiduciary duties owed by directors to shareholders (and possibly creditors) of financially troubled or distressed corporations.[377]

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376. Allen, *supra* note 1, at 2055.

377. *See Chancery Court Finds Parretti Mismanaged MGM/UA, Hands Control to Dutch Bank*, CORPORATE CONTROL ALERT, Feb. 1992, at 1, 16 (noting Chancellor Allen's "suggestion" in Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp., No. 12,150, 1991 Del. Ch. LEXIS 215, at *108 (Del. Ch. Dec. 30, 1991), *reprinted in* 17 DEL. J. CORP. L. 1099 (1992), that "a board's duty might shift from shareholders to creditors *before* a company becomes insolvent, has sparked much discussion among M&A experts").