COMMENT

DEFENDING THE CORPORATE BASTION: PROPORTIONALITY AND THE TREATMENT OF DRACONIAN DEFENSES FROM *UNOCAL* TO *UNITRIN*

I. INTRODUCTION

A full decade has passed since the Delaware Supreme Court revolutionized Delaware takeover law with its decision in *Unocal Corp. v. Mesa Petroleum Co.*[1] In *Unocal*, the Delaware Supreme Court set forth a two-pronged test to determine what actions, undertaken by directors to prevent takeover attempts, fell within the ambit of the business judgment rule. This two-pronged test, known as the proportionality review,[2] required directors to prove that defensive actions were taken because they reasonably perceived a threat to the corporation or its shareholders and that their response was proportionate to that threat.[3] The significance of the *Unocal* standard cannot be overstated. The Delaware Court of Chancery would later hail it as "the most innovative and promising case in our recent corporation law."[4] Delaware courts have since applied the *Unocal* formula as a distinct intermediate standard of review in the context of defending against a hostile takeover[5] and as a flexible model in other takeover situations.[6]

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[1]493 A.2d 946 (Del. 1985).

[2]*See generally* Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247 (1989) (terming the two-prong test in *Unocal* as proportionality review).

[3]*Unocal*, 493 A.2d at 955.

[4]City Capital Assocs. Ltd. Partnership v. Interco Inc., 551 A.2d 787, 796 (Del. Ch. 1988) [hereinafter *Interco*]. *See also* Robert A. Prentice & John H. Langmore, *Shareholder Alternatives to Hostile Takeovers: Restructurings, Auctions, and* Macmillan II, 20 SETON HALL L. REV. 4, 14 (1989) (describing *Unocal* as "a case which has become arguably the most important ever decided regarding the application of the business judgment rule to target defensive tactics").

[5]*See, e.g.*, Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049, 1056 (Del. 1988) (going so far as to define specific criteria to be applied within *Unocal*'s intermediate standard of review); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1350 (Del. 1985) (applying the *Unocal* standard to a situation in which "a defensive mechanism [was] adopted to ward off possible future advances" rather than as a "reaction to a specific threat").

[6]*Compare* Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 278, 286 (Del. Ch. 1989) (stating that *Unocal*'s framework applies to evaluate board action taken for the purpose of impeding the stockholder franchise) *with* Paramount Communications Inc. v. QVC Network

The Delaware Supreme Court's recent decision in *Unitrin, Inc. v. American General Corp.*,[7] developed and clarified the *Unocal* test and paradigm.[8] *Unitrin* involved a board's use of a poison pill rights plan and stock repurchase program in its attempt to repel an unwanted tender offer.[9] In the course of upholding the board's conduct, the Delaware Supreme Court reformulated the proportionality aspect of the *Unocal* test while, at the same time, reaffirming the principles underlying that decision.[10] Specifically, the reformulation involved the splintering of *Unocal*'s proportionality prong into two segments: first, a determination of whether the challenged defensive action is "draconian" such that it precludes or coerces shareholder choice; and, second, an evaluation of whether the board action, if not draconian, falls within the "range of reasonableness."[11]

Although the *Unitrin* court never explained how it would treat draconian responses, case law suggests, and it is the premise of this comment, that in the future such board action may be subjected to a higher standard of review. For instance, the chancery court employed a heightened standard of review in *Blasius Industries, Inc. v. Atlas Corp.*,[12] where the court required a "compelling justification" for board action having the primary purpose and effect of frustrating stockholder voting power.[13] Should this prove to be the case, *Unitrin* should have two lasting effects on Delaware corporate law. First, it will create expressly defined limits on a board's authority to displace shareholder choice, when acting in defense of a takeover. Second, and conversely, it will grant a board greater discretion to act within the parameters of that authority.

To establish the basis for this view of *Unitrin*, Part II of this comment reviews the origin of *Unocal*'s proportionality review and reexamines its application in some of Delaware's prior takeover decisions. More specifically, this section focuses on identifying board conduct

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Inc., 637 A.2d 34, 45 (Del. 1993) (applying *Unocal*'s two-pronged format to review of director action in the context of a sale of control).

[7]651 A.2d 1361 (Del. 1995).

[8]*Id.* at 1367.

[9]*Id.* at 1370-71.

[10]*Id.* at 1385-91.

[11]*Unitrin*, 651 A.2d at 1385-90. For an explanation of the "range of reasonableness," see *infra* note 107.

[12]564 A.2d 651, 661-63 (Del. Ch. 1988).

[13]*Id.* Although *Blasius* justified its increased standard of review on the importance Delaware courts have traditionally attached to the shareholder proxy, this comment will demonstrate that an analogous standard may have application in other contexts where shareholder choice is made ineffectual by board action. *See infra* notes 122-29 and accompanying text.

labeled coercive or preclusive and on analyzing the courts' treatment of such measures under traditional proportionality analysis. Part III examines the Delaware Supreme Court's decision in *Unitrin* and its revision of *Unocal*'s proportionality analysis. Finally, Part IV evaluates the impact of *Unitrin*'s reformulated proportionality prong when applied to both draconian responses and those which conceivably fall within the range of reasonableness.

II. THE DEVELOPMENT AND APPLICATION OF PROPORTIONALITY REVIEW

A. Unocal's *Genesis*

The application of heightened[14] and intermediate forms of scrutiny represents the exception rather than the rule as far as judicial review of board decisions are concerned.[15] In most circumstances, including the takeover context, the business judgment rule operates to protect board decisions through a "presumption that in making a business decision 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."[16] When directors are acting in defense of a takeover, however, Delaware courts have long recognized the need to apply some

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[14]By use of the term, "heightened" scrutiny, reference is primarily made to the entire fairness standard employed in Delaware. *See, e.g.*, Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983) (explaining the entire fairness test). Briefly, entire fairness demands greater justification for a board's actions in that directors are not afforded the protection of the business judgment rule unless they demonstrate that the challenged transaction is both procedurally and substantively fair to the complaining stockholders. *Id.* at 711-15.

Fair dealing and fair price are the two elements comprising the entire fairness test. In making a determination as to fair dealing, the court will consider factors such as the timing of the transaction; the manner in which the transaction was initiated, structured, and disclosed to directors; and the way in which approval from directors and stockholders was obtained. *Id.* at 711. The determination of fair price rests on such factors as the economic and financial aspects of the merger (i.e., the assets, market value, earnings, and future prospects). *Id.*

[15]*Cf.* Pogostin v. Rice, 480 A.2d 619, 627 (Del. 1984) (noting that the business judgment rule applies in the takeover context).

[16]Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). As a result, Delaware courts generally will not review the merits of a board's decision unless the plaintiff can demonstrate grounds why the business judgment rule should not apply. *Id.* This presumption of the validity of director actions stems largely from the recognition that directors, rather than stockholders, are the managers of the corporation. *Id.* at 811. Furthermore, the Delaware General Corporation Law has statutorily recognized this fact. *See* DEL. CODE ANN. tit. 8, § 141(a) (1994) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . .").

threshold level of scrutiny before affording board decisions the protection of the business judgment rule.[17] This intermediate level of scrutiny largely involves a judicial recognition that "a hostile takeover creates a potential conflict of interest, no matter what response it evokes from management."[18]

Long before T. Boone Pickens was a name feared in corporate board rooms,[19] the Delaware courts began experimenting with intermediate levels of review when considering defensive actions taken by a board of directors. In *Cheff v. Mathes*,[20] the case most often cited as exemplifying Delaware's pre-*Unocal* approach, the court articulated a primary purpose or motive-oriented test.[21] Under this test, the board only needed to prove "reasonable grounds to believe a danger to corporate policy and effectiveness existed by the presence of the [insurgent] stock ownership."[22] This burden was satisfied "by showing good faith and reasonable investigation."[23] Whether this approach was adequate at the time *Cheff* was decided is not clear.[24] What is clear, however, is that by the early eighties, with the takeover market rumbling through board

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[17]*See, e.g.*, Bennett v. Propp, 187 A.2d 405, 409 (Del. 1962). The court recognized the basic dilemma directors are confronted with when addressing a takeover threat, stating: "We must bear in mind the inherent danger in the purchase of shares with corporate funds to remove a threat to corporate policy when a threat to control is involved. The directors are of necessity confronted with a conflict of interest, and an objective decision is difficult." *Id.*

[18]Gilson & Kraakman, *supra* note 2, at 247.

[19]T. Boone Pickens was notorious in the early eighties as a "greenmailer" for his practice of acquiring substantial positions in companies to induce them to buy him out at considerable premiums over market price. *See, e.g.* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1337 n.1 (Del. 1987) (noting that Pickens was involved in the attempted hostile takeover); *Unocal*, 493 A.2d at 956 (taking judicial notice of Pickens' greenmailing practices).

[20]199 A.2d 548, 554 (Del. 1964).

[21]*Id.* In *Cheff*, the board had expended corporate funds to buy off a shareholder who had acquired substantial holdings in the company's stock. *Id.* at 553. The record disclosed that the shareholder had a history of acquiring and subsequently liquidating companies, had demanded a place on the board, and was thought by the board to have intended to make substantial changes in corporate policy affecting the company's sales force. *Id.* at 551.

[22]*Id.* at 555.

[23]*Id.*

[24]Some commentators have maintained that *Cheff*'s standard was appropriate for the then existing takeover context. *See* Larry E. Ribstein, *Takeover Defenses and the Corporate Contract*, 78 GEO. L.J. 71, 95 (1989) (arguing that the *Cheff* policy test operated effectively in the 1960s takeover environment because takeover defenses then available were rather mild and included such pedestrian measures as defensive acquisitions and stock repurchases). *See also* Gilson & Kraakman, *supra* note 2, at 249 (maintaining that any experienced corporate lawyer could locate some corporate policy dispute between the incumbent board and the plaintiff stockholder; thus, court review inevitably led to the board's decision securing the protection of the business judgment rule).

rooms, conditions warranted a reevaluation of Delaware's intermediate level of review.[25]

The Delaware courts responded with the decision in *Unocal Corp. v. Mesa Petroleum Co.*[26] Although retaining *Cheff*'s subjective policy/motive analysis, the *Unocal* court added a second, objective stage to the intermediate standard of review.[27] The Unocal board was confronted with a two-tiered, front-end loaded tender offer from Mesa Petroleum,[28] already the owner of thirteen percent of Unocal stock, to acquire an additional thirty-seven percent at $54 cash per share.[29] Although Mesa contemplated cashing out the remaining stockholders with "junk bonds" at $54 per share, the value of the bonds was far below that figure.[30]

After considering several alternatives, the Unocal board, comprised primarily of independent directors, determined that the Mesa offer was inadequate and recommended against it.[31] Rather than paying off Pickens to go away, the board unanimously approved a self-tender offer for forty-nine percent of Unocal's outstanding shares at $72 in senior debt securities and specifically denied Mesa the opportunity to tender into it.[32]

The Delaware Supreme Court first evaluated the board's decision under *Cheff*'s familiar standard. They concluded that the board demonstrated reasonable grounds for perceiving a threat to corporate policy and effectiveness from the Mesa offer.[33] The court characterized the Mesa offer as "a classic coercive measure designed to stampede shareholders into tendering at the first tier, even if the price is inadequate, out of fear of what they will receive at the back end of the transaction."[34] Despite its conclusion that the Mesa offer was coercive and grossly

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[25]*See, e.g.*, Robert A. Prentice & John H. Langmore, *Hostile Tender Offers and the "Nancy Reagan Defense": May Target Boards "Just Say No"? Should They be Allowed to?*, 15 DEL. J. CORP. L. 377, 378-79 (1990) (noting boards acted with virtual impunity in defending against changes of control).

[26]493 A.2d 946 (Del. 1985).

[27]*Id.* at 955.

[28]*Id.* at 956. Mesa Petroleum and its principal, T. Boone Pickens, were tagged by the Delaware Supreme Court as having a national reputation as greenmailers. *Id.* at 949, 956.

[29]*Id.* at 949.

[30]*Unocal*, 493 A.2d at 949-50.

[31]*Id.* at 950-51. Putting aside their knowledge of Mesa's dubious reputation, the board, after consulting with investment bankers and legal counsel, determined that the liquidation value of Unocal exceeded $60 per share. *Id.* at 950.

[32]*Id.* at 951. The board reasoned that it was necessary to exclude Mesa to avoid, in effect, financing Mesa's own inadequate offer. *Id.*

[33]*Id.* at 955-56.

[34]*Unocal*, 493 A.2d at 956 (footnote omitted). In addition, the court noted that the back-end junk bond financing was worth much less than the $54 asserted by Mesa. *Id.*

inadequate, the court did not immediately approve the board's action. Extending its scrutiny beyond *Cheff's* limited scope, the court recognized that the inherent conflict of interest, present when takeover action threatens a change of control, warranted limiting a board's discretion "to defeat any perceived threat by any draconian means available."[35]

The court then framed *Unocal's* second prong, articulating what would become the heart of the proportionality analysis. Noting once again the ever present risk that a board in such situations may be acting in its own interest,[36] the court set forth the inquiry as follows:

> A further aspect is the element of balance. If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed. This entails an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise. Examples of such concerns may include: inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on "constituencies" other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, and the quality of securities being offered in the exchange. . . . [A] board may reasonably consider the basic stockholder interests at stake, including those of short term speculators, whose actions may have fueled the coercive aspect of the offer at the expense of the long[-]term investor.[37]

The court applied this framework in light of Mesa's coercive, two-tiered, and grossly inadequate offer, and concluded that Unocal's response was reasonable in relation to the threat posed by Mesa's offer.[38] It reached

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[35] *Unocal*, 493 A.2d at 954-55.

[36] *Id.* at 955. That the court had concerns about underlying entrenchment motives of board acting in a defensive posture is apparent from its references to Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971). *Unocal*, 493 A.2d at 955. The *Schnell* case stands for the proposition that inequitable actions by fiduciaries will not be tolerated, notwithstanding the fact that such actions may be consistent with the directors' statutory and contractual obligations. *Schnell*, 285 A.2d at 439-40.

[37] *Unocal*, 493 A.2d at 955-56 (footnote omitted).

[38] *Id.* at 956. The court apparently accepted the board's arguments that the selective exchange was necessary to either defeat Mesa's inadequate offer or, if Mesa prevailed, to provide some fair measure of compensation to the remaining public stockholders. *Id.*

this conclusion notwithstanding, and apparently not considering, the fact that Unocal's self-tender was itself coercively structured.[39]

B. *Application of* Unocal*'s Proportionality Review*

Delaware cases subsequently decided under *Unocal*'s rubric have attempted to further define what defensive actions comported with *Unocal*'s proportionality requirements.[40] In light of the *Unocal* decision, this task involved a comparison of the nature and extent of the threat posed by the hostile offer with the character of the board's response.[41] Few of these decisions, however, presented the courts with would be acquirers who posed such undeniable threats to defending corporations as T. Boone Pickens and Mesa Petroleum.[42] As a result, these decisions, in addition to evaluating the nature of the threat posed, directed increasing attention to the nature of the defending board's responses.

Two forms of responses by target boards have attracted the increased scrutiny of the Delaware courts: (1) defensive responses characterized as coercive in that they leave shareholders with no rational choice but to accept the alternative presented by the board,[43] and (2) preclusive responses that bar shareholder choice by denying them the opportunity to receive offers.[44] Within *Unocal*'s framework, these

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[39]Unocal's self-tender extended to 49% of the outstanding shares excluding those held by Mesa. *Id.* at 951. The record contained no evidence of Unocal's having made provision for the repurchase of the remaining public shares. *Id.* at 949-51. Thus, a rational shareholder would be forced to either tender to Mesa for an inadequate price with the risk that the Mesa offer would be withdrawn if not successful or accept Unocal's self-tender to avoid the dual risks of being locked into a highly leveraged company or being cashed out at an inadequate amount at some later date. *See* Marcel Kahan, Paramount *or Paradox: The Delaware Supreme Court's Takeover Jurisprudence*, 19 J. CORP. L. 583, 587 (1994).

[40]*See supra* note 11 and accompanying text (enunciating the two prongs of *Unocal*'s proportionality requirement).

[41]*Unocal*, 493 A.2d at 955.

[42]*Cf.* Lucian A. Bebchuk & Marcel Kahan, *A Framework for Analyzing Legal Policy Toward Proxy Contests*, 78 CAL. L. REV. 1073, 1081-82, 1134 (1990) (observing that coercive two-tiered tender offers have waned in the face of more advanced takeover defenses).

[43]One chancery court decision provided a useful working definition of a "coercive" response by posing the following question: "May the Company Transaction be said to be coercive in the sense that no rational profit-maximizing shareholder can reasonably be expected to reject it?" AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 113 (Del. Ch. 1986).

[44]The chancery court's decision in *Interco* identified the characteristics of a preclusive response as one "that, as a practical matter, withdraws from the shareholders the option to choose between the offer and the status quo or some other board sponsored alternative." *Interco*, 551 A.2d at 797. Regardless of whether the decision is characterized as preclusive or coercive, shareholders are ultimately left with no effective choice.

responses are attacked as disproportionate to the threat posed.[45] Delaware case law upholds defensive actions reasonably characterized as coercive or preclusive.[46] However, defensive actions under *Unocal*'s intermediate standard of review have not been invalidated absent a finding of a coercive or preclusive effect on the shareholders.[47]

The Delaware Court of Chancery's decision in *AC Acquisitions Corp. v. Anderson, Clayton & Co.*[48] illustrates coercive board action. The plaintiff, AC Acquisition Corporation, commenced a tender offer at $56 per share for fifty-one percent of Anderson, Clayton, with a second-step merger at the same price if the tender offer succeeded.[49] The board's financial advisors were unable to tell the board that the plaintiff's offer price was unfair.[50] Nevertheless, the board, ostensibly reasoning that the shareholders desired an alternative transaction, effectuated a self-tender for sixty-eight percent of the outstanding shares at $60 per share.[51] The board's action permitted tendering shareholders to retain a "stub" equity interest in the firm.[52]

The chancery court enjoined the board's defensive response.[53] Noting that the plaintiff's offer only threatened shareholders preferring an alternative which allowed them to retain some form of equity interest, the court accepted the board's argument that a company sponsored

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[45]*Id.* at 796. A finding of defensive steps disproportionate to ward off a takeover attempt has occurred only twice. *Id.* at 796 n.9 (citing Robert M. Bass Group, Inc. v. Evans, 552 A.2d 1227 (Del. Ch. 1988), and AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986)).

[46]*See, e.g. Unocal*, 493 A.2d at 958 (upholding board's two-tiered partial tender offer enacted in response to a like offer from a corporate raider). *See also supra* note 39 and accompanying text (discussing Unocal's tender offer).

[47]The Delaware courts have issued decisions invalidating board actions, not coercive or preclusive in effect, because they violated *Unocal*'s first prong where the board failed to adequately demonstrate that it acted reasonably to ascertain the existence of a threat. *See, e.g.* Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 257, 269-71 (Del. Ch. 1989) (applying entire fairness scrutiny upon finding that a board failed *Unocal*'s first prong because it had been uninformed and failed to perform a *Unocal* analysis when it enacted an "ESOP," a stock equity plan providing anti-takeover protection).

[48]519 A.2d 103 (Del. Ch. 1986).

[49]*Id.* at 109.

[50]*Id.* at 110. At trial, the defendants conceded the fairness of the plaintiff's offer. *Id.* at 112.

[51]*Id.* at 109-10. The board also authorized the corporation to sell 1.4 million shares to the newly created ESOP. *Id.* at 108.

[52]*AC Acquisitions*, 519 A.2d at 108-09. The "stub share" represents the approximate value at which a company share may trade following the consummation of a merger. *Id.* at 108 n.6. In *AC Acquisitions*, the "stub share" represented 34.5%, between $52.34 and $57.34, of the estimated value of one share after the company transaction. *Id.*

[53]*Id.* at 114.

transaction, designed to preserve shareholder choice, represented a reasonable response.[54] However, the transaction formulated by the board actually left a rational shareholder with no choice, as the following passage indicates:

> I conclude as a factual matter . . . that no rational shareholder could afford not to tender into the Company's self-tender offer at least if that transaction is viewed in isolation. The record is uncontradicted that the value of the Company's stock following the effectuation of the Company Transaction will be materially less than $60 per share. . . . The only way, within the confines of the Company Transaction, 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 . . . .[55]

Due to the highly coercive nature of the company's response, the minimal threat posed by the plaintiff's offer, and the availability of less drastic measures to provide shareholders with an effective choice, the court found the board action disproportionate to the threat posed.[56]

The chancery court has also enjoined preclusive responses in a number of instances when defensively motivated transactions were structured to deny shareholders the choice to sell their stock or any vote on the management supported transaction.[57] In *City Capital Associates v. Interco Inc.*,[58] the plaintiff proposed an all cash for all shares tender offer at $74 per share, contingent on the receipt of seventy-five percent of Interco's outstanding stock and its redemption of poison pill stock rights.[59] The rights plan contained both "flip in" and "flip over" provisions which, when triggered, would monumentally increase the cost to acquire the company.[60] The Interco board responded to the plaintiff's

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[54]*Id.* at 112-13.

[55]*Id.* at 113.

[56]*AC Acquisitions*, 519 A.2d at 112-14.

[57]*See Grand Metro. Pub. Ltd.*, 558 A.2d at 1060 (finding draconian and preclusive a board's refusal to redeem poison pill stock rights in face of all shares and all cash tender offer at a price characterized as generous); *Robert M. Bass Group*, 552 A.2d at 1242 (striking down management sponsored restructuring which was economically inferior to plaintiff's tender offer and structured so that no shareholder vote was required).

[58]551 A.2d 787 (Del. Ch. 1988).

[59]*Id.* at 792-94.

[60]The "flip in" provision was triggered upon a suitor's acquisition of 30%, later reduced

offer by refusing to redeem the poison pill and by proposing an intricate restructuring valued at $76 per share which, among other things, involved the sale of one of the company's principal businesses.[61] The purpose of the board's decision was to deny shareholders any opportunity to sell their stock so long as the poison pill remained in place.[62]

The chancellor first restated his conclusion that an all shares for all cash tender offer, similar to City Capital's, represented a threat only if price was inadequate, and then only to shareholder interests, not those of the corporation as an ongoing enterprise.[63] The court further acknowledged that, despite the minimal threat created by the plaintiff's offer, the Interco board was not per se forbidden to preclude shareholders from choosing to tender their shares.[64] However, the court stated that the only legitimate (i.e., proportional) justification for leaving the pill in place was to improve the board's bargaining position or to afford the board time to develop a better alternative for the shareholders.[65] In this case, the chancellor found that the board's decision furthered neither of the articulated aims.

> [R]ecognizing the relative closeness of the values [between the plaintiff's and the board's transactions] and the impossibility of knowing what the stub share [remaining after the completion of the board's proposed transaction] will trade at, the board, having arranged a value maximizing restructuring, elected to preclude shareholder choice. It did so not to buy time in order to negotiate or arrange possible alternatives, but asserting in effect a right and duty to save shareholders from the consequences of the choice they might make, if permitted to choose.

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to 15%, of the outstanding stock and permitted the rights holder to purchase two shares for each share previously held. *Id.* at 791. The "flip over" provision allowed the holder to purchase stock in the surviving corporation having twice the value of the exercise price in the event of a merger or acquisition of 50% of Interco's stock. *Id.* at 791-92.

[61] *Id.* at 792-94.

[62] *Interco*, 551 A.2d at 795. Leaving the pill in place, the board contended, was reasonable to protect the restructuring and achieve a better value for the stockholders in light of the inadequate offer. *Id.*

[63] *Id.* at 797 ("[I]n the special case of a tender offer for all shares, the threat posed, if any, is not importantly to corporate policies . . ., but rather the threat, if any, is most directly to shareholder interests.").

[64] *Id.* at 797-98.

[65] *Id.* at 798. The court's limited view of the board's legitimate purposes derived from its narrow estimate of the threats posed by an offer, the only failing of which was its financial inadequacy. *Id.* at 798-99.

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> To acknowledge that directors may employ the recent innovation of "poison pills" to deprive shareholders of the ability effectively to choose to accept a noncoercive offer, after the board has had a reasonable opportunity to explore or create alternatives, or attempt to negotiate on the shareholders' behalf, would, it seems to me, be so inconsistent with widely shared notions of appropriate corporate governance as to threaten to diminish the legitimacy and authority of our corporation law.[66]

Thus, by invoking some of the most fundamental principles of Delaware corporate law related to the allocation of power between the owners and managers of a corporation,[67] the court found that the offer in these circumstances did not warrant such a drastic measure as to eliminate shareholder choice.[68]

Although the Delaware Supreme Court has since rejected the chancery court's position that a non-coercive all cash offer for all shares of a company's stock poses no threat to the corporation as an enterprise,[69] the theme of shareholder choice still remains viable. The Delaware Supreme Court's decision in *Time-Warner* recognized that a hostile tender offer can threaten adverse consequences for a corporation and its shareholders, including those created by structural coercion from two tiered offers at an inadequate value.[70] The court's willingness, however, to recognize more nebulous threats posed by, for example, inadequate information to shareholders or the possibility of tainting a company's

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[66]*Interco*, 551 A.2d at 799-800.

[67]The chancery court's decision appears to implicate considerations of shareholder choice or shareholder autonomy. For a further discussion of the principles underlying the doctrine of shareholder choice, see *infra* note 75.

[68]*Interco*, 551 A.2d at 800.

[69]*See* Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1152-53 (Del. 1989) (hereinafter *Time-Warner*).

[70]*Id.* As the *Time-Warner* court reasoned, the flaw in the chancery court's rationale was not its reliance on the idea of a shareholder's limited right to choose when to sell, but its failure to recognize the full scope of threats that might be posed by an all cash for all shares offer:

> Implicit in the . . . argument is the view that a hostile tender offer can pose only two types of threats: the threat of coercion that results from a two-tier offer promising unequal treatment for nontendering shareholders; and the threat of inadequate value from an all-shares, all-cash offer at a price below what a target board in good faith deems to be the present value of its shares. . . . We disapprove of such a narrow and rigid construction of *Unocal* . . . .

Id.

corporate culture, does not displace shareholder choice as a consideration within the framework of *Unocal*. A board's defensive decisions which preclusively or coercively eliminate a shareholder's ability to buy or sell an equity interest should still require greater justification than those which do not substantially restrict shareholder choice.[71] *Time-Warner* merely recognizes that, in certain situations, additional considerations may be present which ultimately validate a board's decision.

III. *UNITRIN*'S REVISION OF THE *UNOCAL* STANDARD

Whereas previous Delaware court decisions concentrated on refining the application of *Unocal*'s framework, the Delaware Supreme Court's recent decision in *Unitrin, Inc. v. American General Corp.*[72] went one step further by reformulating the traditional proportionality analysis.[73] Unitrin's revised proportionality test requires that defensive actions which coercively or preclusively shift control from shareholders to management be supported by additional justifications.[74] In so doing, the court finally acknowledged the importance of shareholder choice[75] in the corporate

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[71]This view does not ignore language in *Time-Warner* maintaining that Delaware law places the decision only with management to determine the time frame for achieving corporate goals and, therefore, bars management from delegating that decision to stockholders. *Id.* at 1154. The existence of such long-term corporate goals may well justify a board's use of more severe measures than would otherwise be available to it. However, the court subsequently proceeded to find that the board's responses neither coercively "crammed down" a management sponsored alternative on the shareholders, nor precluded future offers for the combined company following the merger. *Id.* at 1155. Thus, *Time-Warner* does not reach the issue of whether these considerations would permit management to absolutely foreclose shareholder choice.

[72]651 A.2d 1361 (Del. 1995).

[73]*See infra* notes 102-09 and accompanying text.

[74]*Unitrin*, 651 A.2d at 1387-88.

[75]The doctrine of shareholder choice or autonomy embodies the idea that the nature of the corporate form, at least to a limited extent, preserves shareholders' power over management through their ability to transfer control by means of the shareholder vote and sale of their equity interest. *See, e.g., Blasius*, 564 A.2d at 659 ("[S]hareholders have only two protections against perceived inadequate business performance. They may sell their stock . . . or they may vote to replace incumbent board members."). The rationale for preserving shareholder choice is to take advantage of the market for corporate control:

> The shareholders' removal power is particularly significant because it permits the shareholders to trump many directors' attempts to thwart takeovers, especially when the directors fail to initiate a sale, merger, or dissolution.
>
> The shareholders' power to control managers' actions by voting seems to be an empty technicality in public corporations because an individual shareholder typically owns too little stock to justify active involvement in corporate governance. What gives meaning to the shareholders' vote in this

realm.

A. Unitrin's *Background*

The decision in *Unitrin* evolved from a takeover battle in which American General Corporation, the nation's largest home service insurance provider, sought to acquire Unitrin, Inc., the third largest company in the industry.[76] The contest commenced when American General made an all cash offer to acquire all of Unitrin's outstanding common stock for $50 3/8 per share.[77] Despite the offer's thirty percent premium over market price, Unitrin's board of seven directors[78] unanimously resolved to reject American's proposal.[79] The board's stated reasons for its opposition included its conclusions that: (1) Unitrin's intrinsic stock value exceeded the offer price; (2) Unitrin's long-term outlook as an independent company suggested greater value than American's offer provided; (3) given Unitrin's current strong financial standing, it was in position to independently pursue other opportunities; and (4) a combination with American General would potentially violate antitrust laws.[80]

Based on these observations, the board enacted several devices adding to its existing array of anti-takeover defenses.[81] First, the board added a sixty-day advance notice provision to its bylaws.[82] Second, the directors approved a poison pill containing "flip-in" and "flip-over" provisions which triggered when a single stockholder acquired fifteen

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> setting, and therefore explains its survival as a contract term, is the market for corporate control; . . . The market for control disciplines manager conduct by providing a mechanism both for removal of managers who fail to maximize share value and for disapproval of inefficient transactions.

Ribstein, *supra* note 24, at 80. *See also* Prentice & Langmore, *supra* note 4, at 22-23 (recognizing cases which "expressly [stress] shareholder freedom of choice as a variable of independent and increasing significance").

[76] *Unitrin*, 651 A.2d at 1367.

[77] *Id.*

[78] Of the seven member Unitrin board, only two were employed in the company's management. Also, the board collectively owned at least 23% of Unitrin's outstanding stock with a total value of about $450 million at American General's offer price. *Id.* at 1367-68.

[79] *Id.* at 1369.

[80] *Unitrin*, 651 A.2d at 1370.

[81] Unitrin already had in its bylaws a super-majority voting provision which required any merger to be approved by seventy-five percent of the stockholders. *Id.* at 1370, 1377.

[82] *Id.* at 1370; *In re* Unitrin, Inc. Shareholders Litig., 1994 Del. Ch. LEXIS 187, at *7 (Del. Ch. Oct. 13, 1994). The advanced notice provision was neither challenged nor explicitly considered in either the chancery or supreme courts' decisions.

percent ownership.[83] Finally, the board authorized Unitrin to repurchase up to ten million shares.[84]

In response, American General and a group of stockholder plaintiffs sought to enjoin the board's actions in the court of chancery. American General challenged the board's repurchase program while the stockholder plaintiffs argued that both the poison pill and repurchase program must be stricken.[85] After entertaining arguments on whether Unitrin's board reasonably perceived a threat to the corporation, the court concluded that the board had properly perceived a threat to the corporation but that the threat posed was mild.[86] The threats posed only a danger to corporate policies and to the stockholders caused by the arguably inadequate opening price.[87] The court next considered the poison pill under *Unocal*'s second prong. The vice-chancellor found the board to have acted consistently with its fiduciary obligations in approving the poison pill because, at this early stage of the process, the poison pill represented an appropriate tool to force American General to increase what the board believed to be an inadequate opening bid.[88]

The trial court then devoted the bulk of its decision to evaluating the suitability of the repurchase program under *Unocal*'s proportionality test. Scrutinizing the repurchase program in light of Unitrin's existing defenses, the vice-chancellor invalidated the repurchase program as "unnecessary."[89] The court reasoned that the repurchase program, combined with the supermajority voting provision, did "more than protect uninformed stockholders from an inadequate offer, it chill[ed] any unsolicited acquirer from making an offer."[90] According to the court, this potpourri of defenses, in addition to absolutely precluding a tender offer would, when combined with the twenty-three to twenty-eight percent equity interest of the directors voting as stockholders, virtually preclude any rational shareholder from undertaking a proxy contest.[91] Even if

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[83] *Unitrin*, 651 A.2d at 1369-70; *In re Unitrin, Inc. Shareholders Litig.*, 1994 Del. Ch. LEXIS 187, at *9 (Del. Ch. Oct. 13, 1994). See *supra* note 60 for a discussion of the operation of "flip in" and "flip over" provisions.

[84] *Unitrin*, 651 A.2d at 1370-71.

[85] *In re Unitrin Shareholder Litig.*, 1994 Del. Ch. LEXIS 187, at *17.

[86] *Id.* at *23-24.

[87] *Id.* In making this determination, the court discounted the defendants' antitrust concerns, finding that they were only a "makeweight excuse." *Id.* at *23.

[88] *Id.* at *26-27.

[89] *In re Unitrin, Inc. Shareholders Litig.*, 1994 Del. Ch. LEXIS 187, at *26-32.

[90] *Id.* at *32.

[91] *Id.* at *28-31. As the court saw it, this arrangement was impermissably preclusive because it "was designed to keep the decision to combine with American General within the control of the members of the board under virtually all circumstances." *Id.* at *27.

American General substantially increased its offer, the Unitrin director-stockholders were unlikely to tender because of their self-interest in retaining their positions on the board.[92] Finally, the court noted, an added level of preclusion derived from the supermajority voting provision which would permit the stockholder-directors to block any merger even if a proxy contest could succeed.[93]

B. *The Supreme Court Decision*

The Delaware Supreme Court reversed the court of chancery, both for relying on several factual premises unsupported by the record and, more importantly, for misapplying the *Unocal* proportionality test by holding that the repurchase program was unnecessary. The supreme court first rejected the chancery court's assumption that the stockholder/directors would fail to vote in support of an American General proxy campaign because they placed greater value on their positions as directors than on the economic benefits that would flow to them as stockholders.[94] Contrary to the trial court's conclusion, the supreme court found that the existence of the supermajority voting provision was superfluous to American General's ability to prevail in a proxy contest or thereafter to effectuate a merger.[95] Moreover, the

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[92] *Id.* at *30-32. The court reasoned that the omnipresent specter of self-interest which *Unocal* cautioned against extended to a director's subjective perception that the prestige and perquisites of management would outweigh any economic advantage of selling. *Id.* at *31-32. Thus, assuming the board continued to present a united front, the court calculated that American would have to outpoll management by over a three to one ratio to prevail in a proxy fight. *Id.* at *29.

[93] *In re* Unitrin, Inc. Shareholders Litig., 1994 Del. Ch. LEXIS 187, at *30.

[94] *Unitrin*, 651 A.2d at 1380. The court stressed that no basis existed in the record to assume that directors who were also substantial stockholders would not vote consistent with their economic interest. Without such record support, the court opined, the directors' interests as stockholders were presumed to dominate any contrary interest in holding on to board positions. *Id.*

[95] *Id.* at 1381-83. Referring to what it called the chancery court's persistent misunderstanding of the supermajority voting provision, the court clarified that the provision would only become effective if American General acquired more than 15% of Unitrin stock, obtained a plurality to prevail in the proxy contest, and then sought to cause a merger of the two companies without the approval of the board of directors. However, this combination of prerequisites in effect render the supermajority provision a nullity because the poison pill trigger at 15% would prevent American General from ever passing that level of ownership. *Id.* at 1381-82. Likewise, the supermajority voting rule would not apply if Unitrin were to succeed in its proxy contest and then seek to merge the companies because such a merger would be supported by the newly elected American General board. *Id.* at 1381-83. Therefore, American General needed only to outpoll Unitrin by a plurality to prevail in a proxy contest and, pursuant to DEL. CODE ANN. tit. 8, § 251 (1994), was obligated only to obtain a majority

supreme court determined that completion of the repurchase program would not preclude shareholders from passing control to American General.[96]

Having concluded that the proxy contest remained a viable avenue to shift control despite Unitrin's defenses, the supreme court subjected the board's responses to *Unocal*'s intermediate standard of review. Under *Unocal*'s first prong, the court affirmed the chancery court's conclusion that Unitrin's board reasonably perceived a threat of substantive coercion[97] posed by American General's offer.[98] Finally, addressing *Unocal*'s proportionality aspect, the supreme court ruled that the court of chancery erred as a matter of law in two respects: (1) by holding that the repurchase program was "unnecessary," rather than determining whether

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vote of the stockholders to thereafter merge the two firms. *Unitrin*, 651 A.2d at 1381-83.

[96]*Unitrin*, 651 A.2d at 1383. At this point the court launched into some complex calculations, which in effect demonstrated that the defenses, even with the supermajority voting provision in place and the repurchase program fully consummated, would not present an insurmountable barrier to pass. *Id.* at 1382-83. Assuming a 90% voter turnout, American General, as a 14.9% stockholder, would only have to obtain the votes of an additional 30.2% of shareholder votes to achieve the plurality necessary to replace the directors and 35.2% of votes for a normal majority to bring about a follow up merger. *Id.* Furthermore, while directors would own 28% of the stock following the repurchase program, American General needed only to obtain support from about one-half to two-thirds of the 57.1% of outstanding stock held by public shares. *Id.*

An additional point highlighted by the court deserves comment. The court noted that institutional investors controlled 42% of Unitrin's outstanding stock. *Id.* at 1382. Realizing that such institutional investors were more likely than the average stockholder to judge a proxy contest based on the virtues of the issues presented, the court suggested that garnering the support this block alone could allow American General to prevail. *Id.*

[97]*Id.* at 1383-85. In their seminal article on proportionality review, Professors Gilson and Kraakman coined the term "substantive coercion," defining it as the threat that:

> shareholders might somehow be led to accept unfavorable substantive terms voluntarily. Put another way, substantive coercion posits a likely mistake by target shareholders who would not accept the terms of an acquirer's offer if they knew what management knew about their own company, about the acquisitions market, or about management itself.

Gilson & Kraakman, *supra* note 2, at 259.

[98]*Unitrin*, 651 A.2d at 1384. In this regard, the court again repeated Delaware's position that the threat posed by inadequate value included the danger of substantive coercion to the corporate enterprise based on shareholders' ignorance or mistaken beliefs about the merits of the offer. *Id.* (citing *Time-Warner*, 571 A.2d at 1152-53). As a result, the court accepted as legitimate three of the concerns raised by Unitrin's board in support of its belief that the offer posed a cognizable threat: "[F]irst, the inadequacy of the price offered; second, the nature and timing of American General's Offer; and third, the basic stockholder interests at stake, including those of short-term speculators whose actions may have fueled the coercive aspect of the Offer at the expense of the long-term investor." *Id.* at 1385.

it fell within the range of reasonableness;[99] and (2) by the "substitution of [the court of chancery's] business judgment for that of the Board."[100]

While the court found a sufficient basis within *Unocal*'s existing framework to uphold the board's actions,[101] it nevertheless proceeded to modify *Unocal*'s second prong. The supreme court's reformulated proportionality test distinguishes board responses on the basis of whether or not they implicate draconian consequences for the shareholders or the enterprise.[102] The revised proportionality inquiry now breaks down into two subquestions: first, whether the challenged defenses are draconian such that they either are inherently coercive or preclusive in their effects on the corporation's stockholders;[103] and second, if not draconian, whether the board's response conforms to the "range of reasonableness."[104]

The court attempted to define its terminology with reference to the case law decided under *Unocal*'s framework. Citing *AC Acquisitions Corp. v. Anderson, Clayton & Co.*, the court first suggested that a coercive response would rise to a draconian level when it not only daunted any rational stockholder from participating in the current offer but similarly affected future offers.[105] Likewise, preclusive responses are actionably draconian when they render a takeover attempt by the current

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[99]*Id.* at 1386.

[100]*Id.*

[101]In this regard, the court cited favorably to Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 278 (Del. Ch. 1989), which upheld a similar board action under analogous circumstances within the traditional *Unocal* framework. *Unitrin*, 651 A.2d at 1389.

[102]*Unitrin*, 651 A.2d at 1387. According to the court, the concept of draconian defenses had developed through common law application recognizing that certain defenses are either preclusive or coercive. *Id.*

[103]*Id.* at 1388.

[104]*Id.* at 1389.

[105]*Id.* at 1388. Here the court emphasized that the repurchase program was not "inherently coercive" because of its limited scope and its non-discriminatory character. *Id.* This reference might suggest that the court intends to give an exceedingly narrow construction to the meaning of "coercive" in this context. Arguably, the only defense that will be "inherently coercive" is the two-tiered front loaded self-tender offer. When such a defense is employed, shareholders are pressured to tender by the threat of diminished value embodied in the offer. *See* 2 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 6.49 (Supp. 1995). Other forms of coercion, often referred to as "substantive coercion," depend upon the existence of additional factors such as shareholder ignorance about the merits of the acquirer's proposal to which their board is responding. *See* Gilson & Kraakman, *supra* note 2, at 259-65 ("The only threat posed by a non-coercive offer that management considers unfair, ill-timed, or underpriced, is the threat that *something* will lead shareholders to accept it.") (emphasis added). Thus, while the two tiered front loaded self-tender offer may consistently be considered coercive, other defenses, such as the all shares for all cash self-tender, will not be coercive in most cases.

suitor virtually impossible.[106] Thus, board action, which in the past has been found to unduly restrict shareholder choice will hereafter be labeled draconian within the *Unocal/Unitrin* framework.

In contrast, the court's "range of reasonableness" terminology draws on language from *Paramount Communications, Inc. v. QVC Network, Inc.*,[107] and emphasizes the "need of the board of directors for latitude in discharging its fiduciary duties to the corporation and its shareholders."[108] While the court again did not attempt to provide a comprehensive definition of the "range of reasonableness," it did set out relevant factors for the inquiry:

> [T]he Court of Chancery should take into consideration whether: (1) it is a statutorily authorized form of business decision which a board of directors may routinely make in a non-takeover context; (2) as a defensive response to American General's Offer it was limited and corresponded in degree or magnitude to the degree or magnitude of the threat, (*i.e.*, assuming the threat was relatively "mild," was the response relatively "mild?"); (3) with the Repurchase Program, the Unitrin Board properly recognized that all shareholders are not alike, and provided immediate liquidity to those shareholders who wanted it.[109]

Accordingly, the court's rhetoric suggests that the "range of reasonableness" inquiry involves the same considerations as did *Unocal*'s proportionality analysis.

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[106] *Unitrin*, 651 A.2d at 1388-89. In the case of a proxy contest, the court indicated that a defense would be preclusive if it would cause success to "either be mathematically impossible or realistically unattainable." *Id.* at 1389.

[107] *Id.* at 1388. In *QVC*, 637 A.2d at 44-45, the court discussed the "range of reasonableness" in the context of a sale of control. Despite the different context, the sentiment is largely the same: "[A] court applying enhanced judicial scrutiny should be deciding whether the directors made a **reasonable** decision, not a **perfect** decision." *Id.* at 45. The theme both decisions share is a willingness to afford directors greater discretion.

[108] *Unitrin*, 651 A.2d at 1388.

[109] *Id.* at 1389 (citations omitted). These statements merely echo accepted principles applied in Delaware takeover jurisprudence. The first point emphasizes only that the decision must be supported by statutory or contractual authority. *See, e.g., Moran*, 500 A.2d at 1350 ("[T]he business judgment rule can only sustain corporate decision making or transactions that are within the power or authority of the Board."). The second statement just repeats *Unocal*'s requirement of proportionality. *Unocal*, 493 A.2d at 955. The third assertion recognizes that providing the choice of an alternative transaction to stockholders remains a viable justification for a board's defensive response. *See AC Acquisitions*, 519 A.2d at 112.

Having set out the reformulated proportionality review, the court applied it to the record at hand. In the court's view, the prospect that the repurchase program might defeat American General's current tender offer did not render the defense coercive.[110] Further, the court did not expressly decide but strongly suggested that the defense would not be preclusive in light of its conclusion that a proxy contest remained more than a theoretical possibility.[111] Thus, all that remained for the chancery court on remand was to confirm the supreme court's initial finding, that the defense was not draconian because it was neither coercive nor preclusive, and to examine the defense within the range of reasonableness.[112]

IV. PROPORTIONALITY REVIEW IN THE POST-*UNITRIN* LANDSCAPE

A. *Draconian Responses*

By focusing the inquiry on whether responses are draconian, the court forces one to consider just what treatment will be afforded to coercive or preclusive board defensive actions.[113] The label, draconian, adds little to the analysis if these responses will continue to be reviewed on a "reasonable in relation to" basis.[114] Therefore, if "reasonable in relation to" no longer represents the exclusive mode of analysis, what standard applies to determine the viability of draconian responses? In this respect, the decision provides little guidance.[115]

Two possibilities, however, reveal themselves as models from which to ascertain the level of scrutiny applied to draconian responses. The first approach involves applying a per se rule of invalidity once a defensive action is characterized as exceedingly coercive or preclusive.[116] *Unocal* itself appears to support such a construction with its suggestion

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[110] *Unitrin*, 651 A.2d at 1388.

[111] *Id.*

[112] *Id.* at 1389.

[113] *See supra* text accompanying notes 93-104 (stating the two-pronged proportionality test but not specifying the standard for draconian responses).

[114] *See supra* text accompanying notes 102-04 (defining the reasonableness standard for non-draconian responses).

[115] *See id.*

[116] The recently decided decision of the United States District Court of the District of Delaware in Moore Corp. v. Wallace Computer Servs., Inc., 907 F. Supp. 1545 (D. Del. 1995), exhibits such an approach to draconian board actions. There, the court characterized *Unitrin*'s view of draconian board actions as ones to be "condemned" because they are "not reasonably proportionate to the perceived threat." *Id.* at 1562. This statement suggests that the court viewed such actions as per se invalid under *Unitrin*'s framework.

that draconian responses reach outside the realm of directors' discretion.[117] The *Unitrin* court seemed to further develop this reasoning when it stated: "An examination of the cases applying *Unocal* reveals a direct correlation between findings of proportionality or disproportionality and the judicial determination of whether a defensive response was [D]raconian because it was either coercive or preclusive in character."[118] However, Delaware courts have generally resisted such absolute prohibitions when acting in equity.[119] Such a rule would also force the court to give up a large measure of its discretion in these matters[120] and

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[117]*Unocal*, 493 A.2d at 955. A close reading of *Unocal* reveals that the court first explained that directors powers are not absolute and do not extend to implementing "any Draconian means available." *See id.* The court then discussed the element of balance in the context of proportionality review. *Id.* Viewed in this light, *Unocal* can be construed consistently with *Unitrin* to say that directors do not have the *power* to utilize draconian responses and other responses must be reasonable in relation to the threat posed. *See supra* text accompanying notes 103-04 (defining the standard of review of board conduct).

Interestingly, if one accepts the proposition that, in fending off takeovers, certain defenses fall outside the Board's power, the response in *Unocal* itself may have been impermissibly draconian. Professor Ribstein suggested this in his analysis of the *Unocal* board's response under a corporate contract paradigm. *See* Ribstein, *supra* note 24, at 97, 99. He concluded that the discriminatory self-tender offer applied therein was so effective that it "exceeded the director's power." *Id.* at 97. Furthermore, the offer interfered with shareholder autonomy by preventing Mesa or any other unwanted bidder from buying the company without absorbing high costs. *Id.*

[118]*Unitrin*, 651 A.2d at 1387.

[119]For example, in *Blasius*, Chancellor Allen considered the merits of a per se rule prohibiting board action with the primary purpose of interfering with the stockholder franchise. *Blasius*, 564 A.2d at 662. Although the chancellor realized that the circumstances which might justify such board action would be exceedingly rare, he was nevertheless unwilling to constrain the equity court to such narrow confines:

> In my view, our inability to foresee now all of the future settings in which a board might, in good faith, paternalistically seek to thwart a shareholder vote, counsels against the adoption of a *per se* rule invalidating, in equity, every board action taken for the sole or primary purpose of thwarting a shareholder vote, even though I recognize the transcending significance of the franchise to the claims to legitimacy of our scheme of corporate governance. It may be that some set of facts would justify such extreme action.

Id. (footnote omitted).

[120]Commentators have asserted that Delaware courts evidence more concern for protecting their judicial discretion in complex corporate matters than for articulating workable standards. For example, Professors Brudney and Bratton observe somewhat caustically that Delaware does not "go much distance in articulating workable . . . standards," but rather "opt[s] for unpredictable, if not wholly limitless, judicial discretion to give the [proportionality] formulae whatever content the court sees fit at any particular time." VICTOR BRUDNEY & WILLIAM W. BRATTON, BRUDNEY AND CHIRELSTEIN'S CORPORATE FINANCE 1129 (4th ed. 1993). *See also* Charles M. Yablon, *Poison Pills and Litigation Uncertainty*, 1989 DUKE L.J.

pose the danger of sweeping too broadly.[121] These consequences are likely ones that the court would not want to impose on itself.

The second possible approach would involve applying some other form of heightened scrutiny to the questioned transaction. An analogue for such a standard already exists in Delaware law in the form of the *Blasius* "compelling justification" requirement.[122] This standard recognizes that certain types of board action may inherently subject a firm's stockholders to extreme consequences or deny them basic rights flowing from their equity interest.[123] Accordingly, such tactics are not afforded the protection of the business judgment rule and are subjected to some measure of heightened scrutiny.[124]

In *Blasius,* the chancery court applied the compelling justification standard to a board defensive action which directly manipulated the corporate franchise.[125] This action was an attempt to prevent a majority of stockholders from electing additional directors sympathetic to the acquirer's proposal.[126] The court offered two bases from which to impose this heightened scrutiny. First, the shareholder franchise and the shareholders' right to transfer their equity interest represent the only two avenues available to them to exert some control over their management.[127] Board conduct that frustrates the shareholder franchise eliminates one of these options.[128] Second, board action interfering with the shareholder vote represents an alteration of the fundamental allocation of power between the shareholders and management.[129]

Although the connection between board action aimed directly at the shareholder franchise and that which coercively or preclusively removes shareholder choice in the takeover context may not be readily apparent,

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54, 73-74 (suggesting that Delaware "purposely avoided clarifying the loose standard").

[121]*See Blasius*, 564 A.2d at 661 (discussing the disadvantages of a per se rule in the context of shareholder-franchise).

[122]*Id.* at 661-62.

[123]*See id.* at 661-63 (recognizing the consequences and denial of rights resulting from various board actions). Furthermore, one author has asserted that the only two absolute rights a shareholder obtains from equity ownership are a "residual claim on the assets of the corporation" and a franchise right. Robert J. Klein, Note, *The Case for Heightened Scrutiny in Defense of the Shareholders' Franchise Right*, 44 STAN. L. REV. 129, 138-40 (1991). The shareholders' franchise right must be protected because only it "protects the shareholders' residual property interest." *Id.*

[124]*Blasius*, 564 A.2d at 659.

[125]*Id.* at 662-63.

[126]*Id.* at 662.

[127]*Id.* at 659. *See also supra* note 75 (discussing shareholder choice concept).

[128]*Blasius*, 564 A.2d at 659.

[129]*Id.* at 659-60.

the considerations are largely the same. In the takeover context, the proxy contest has taken on added importance now that poison pills and like defenses have all but foreclosed the tender offer option.[130] Moreover, as *Unitrin* demonstrates, the shareholder's ability to effectively exercise his vote may justify impeding his ability to sell his stock.[131] Similarly, the *Blasius* analysis recognizes the significance of proxy contests in that directors may not render a proxy contest ineffective by manipulating the corporate machinery to change its outcome.[132] Extending this reasoning to the takeover spectrum simply acknowledges that directors cannot, without good cause, do indirectly by foreclosing the possibility of a proxy contest what *Blasius* prevents them from doing directly.[133]

The recently decided case of *Kidsco Inc. v. Dinsmore*[134] brings to the forefront the role the *Blasius* analysis will play in *Unitrin*'s revised framework. The decision clearly demonstrates that, following *Unitrin*, the lines between *Blasius*'s "compelling justification" standard and the traditional *Unocal* test of proportionality have been blurred. Indeed, the vice-chancellor in *Kidsco* viewed the claims before him as raising "the

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[130]*See* Irwin H. Warren & Kevin G. Abrams, *Evolving Standards of Judicial Review of Procedural Defenses in Proxy Contests*, 47 BUS. LAW. 647, 647-49 (1992).

[131]Recall from *Unitrin* that the court acknowledged the board's prerogative to employ defenses forestalling any tender offer because a proxy contest was still feasible. *Unitrin*, 651 A.2d at 1383.

[132]*See Blasius*, 564 A.2d at 663 (disallowing the board's attempt to foreclose shareholder action by manipulating the corporate franchise); Phillips v. Insituform of N. Am., Inc., No. 9173, 1987 WL 16285, at *5-6 (Del. Ch. Aug. 27, 1987), *reprinted in* 13 DEL. J. CORP. L. 774, 783-85 (1988) (recognizing that a board cannot attempt to remove shareholder's control by amending corporate bylaws, issuing new stock, delaying annual meeting, and proposing a merger); Aprahamian v. HBO & Co., 531 A.2d 1204, 1208 (Del. Ch. 1987) (disallowing the board's attempt to defeat a shareholder proxy contest by delaying the annual meeting).

[133]*Unitrin* also raises a more pragmatic consideration which supports limiting the use of draconian responses and preserving at least a limited right to shareholder choice in the takeover context. Institutional investors, although maybe not perfect monitors of the corporation, tend to be better informed and to be more active in exerting their voting rights than the typical public stockholder. See Klein, *supra* note 123, at 133 (observing that it remains unclear whether institutional investors are actively participating in corporate governance); *see generally* Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1992) (analyzing the desirability of institutional oversight). Arguably, then, institutional investors are less susceptible to threats of substantive coercion in deciding how to dispose of their stock or how to vote in a proxy battle because they will not tender into an inadequate offer out of ignorance or mistaken belief. *See* Gilson & Kraakman, *supra* note 2, at 259. Therefore, if the presence of institutional investors results in a more meaningful exercise of shareholder choice, less justification exists for permitting management to utilize draconian measures to deny this choice.

[134]No. 14,649, 1995 Del. Ch. LEXIS 152 (Del. Ch. Nov. 22, 1995), *aff'd*, 670 A.2d 1338 (1995).

question of what form of analysis — *Blasius, Unocal*, or an amalgam of both — is to be employed.[135] The apparent answer is that in most situations, certainly those in which a proxy fight is coupled with a tender offer, the *Blasius* analysis merely represents another articulation of the *Unocal/Unitrin* formula.

The dispute in *Kidsco* arose when two companies, SoftKey International Inc. and Broderbund Software, Inc., entered into a contest to acquire a third software-related company, The Learning Company (TLC).[136] Broderbund had long been the favored suitor of TLC, the two companies having entered into a merger agreement some months before SoftKey entered into the picture.[137] Within days of the pending shareholders meeting at which the TLC/Broderbund merger was to be considered, SoftKey announced its intention to conduct a two-tiered tender offer to acquire for cash a majority of TLC's outstanding shares.[138] Coupled with this was SoftKey's announced intention to call a special meeting under TLC's bylaws for the purpose of holding elections to replace all of TLC's current directors with SoftKey candidates.[139]

TLC's response was immediate. The board, after several meetings among themselves and discussions with representatives of Broderbund aimed at improving the merger consideration, elected, following the advice of its counsel, to amend its bylaw to extend the minimum time in which a special meeting could be called from thirty-five to sixty days.[140] This move permitted TLC to postpone the vote on the Broderbund merger from November 9 to December 11, 1995.[141] In contrast, the

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[135] *Id.* at *37.

[136] *Id.* at *2. SoftKey is the corporate parent of Kidsco, Inc., the first named plaintiff in the chancery court action. *Id.*

[137] *Id.* at *6-7. The TLC board had announced its approval of the merger agreement, a stock for stock merger of TLC into Broderbund, on July 31, 1995. *Id.* at *5-6.

[138] *Kidsco*, No. 14,649, 1995 Del. Ch. LEXIS 152, at *8. While the front end involved payment of $65 cash per share, the back end of the tender offer contemplated a stock for stock merger at the same value for the remaining 49.9% of TLC's outstanding stock. *Id.* at *8-9. This offer was not presented to TLC's shareholders until 10 days before the November 9, 1995 meeting where the Broderbund merger was to be voted upon. *Id.* at *8.

[139] *Id.* at *9-10. Tactically, SoftKey desired this move because its board appointees would remove or render ineffective the rights plan the current board had in place. As the vice-chancellor found, "[T]he sole purpose of the SoftKey-initiated special meeting was to facilitate SoftKey's hostile offer by removing the major obstacle to it." *Id.* at *10.

[140] *Id.* at *11-18. TLC had sought to convince Broderbund to increase the merger consideration. These efforts, however were not entirely successful, and no revised final agreement as yet had been reached by November 6, when TLC announced that it was postponing the meeting for consideration of the Broderbund merger. *Id.* at *11-13.

[141] *Id.* at *14. In addition to giving TLC time to pursue further negotiations with Broderbund, see *supra* note 140, the board had been advised that any increase in merger

meeting demanded by SoftKey could not be held until January 8, 1996.[142] SoftKey thereafter initiated this expedited litigation in an effort to enjoin the implementation of the bylaw amendment and prevent the delay of the meeting.[143]

Among the contentions advanced by SoftKey were two that are relevant to the present discussion. First, SoftKey maintained that the amendment be analyzed under *Blasius*'s "compelling justification" standard and stricken as one "enacted for the primary purpose of impeding the exercise of stockholder voting power . . . ."[144] Second, the plaintiffs asserted that the *Unocal/Unitrin* mode of analysis required the same result because it was a draconian response which "preclude[d] altogether the shareholders' opportunity to decide whether to retain the current board at a December 13, 1995 meeting."[145] Both these contentions were rejected by the chancery court in a way that raises serious questions about the continued viability of *Blasius* as a separate doctrine in the post-*Unitrin* landscape.[146]

In analyzing the claims before it, the chancery court did not go so far as to suggest that *Blasius*'s "compelling justification" standard is really one in the same with the *Unocal/Unitrin* framework. Instead, the vice-chancellor circumscribed the application of *Blasius*. To this end, the court commented:

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consideration would necessitate postponement to obtain SEC clearance. *Id.* at *12.

[142]*Kidsco*, No. 14,649, 1995 Del. Ch. LEXIS 152, at *17. The meeting, which had originally been scheduled to occur two days after the Broderbund vote, would now follow the merger vote by 28 days. *Id.*

[143]SoftKey was joined in its suit by shareholders of TLC in two class actions. *Id.* at *2.

[144]*Id.* at *37.

[145]*Id.* at *36. SoftKey also contended that it posed no cognizable threat to TLC, except to the directors' continued incumbency. *Id.* at *37.

[146]This is not to imply that this case represents the first indication from the Delaware courts that *Blasius* may have only a limited role distinct from that of "enhanced scrutiny" in general. As far back as Stroud v. Grace, 606 A.2d 75 (Del. 1992), the supreme court made the following observation:

> Board action interfering with the exercise of the franchise often arose during a hostile contest for control where an acquiror [sic] launched both a proxy fight and a tender offer. Such action necessarily invoked both *Unocal* and *Blasius*. We note that the two "tests" are not mutually exclusive because both recognize the inherent conflicts of interest that arise when shareholders are not permitted free exercise of their franchise.

Id. at 92 n.3. *Kidsco*, however, is the first case to address the point following the Delaware Supreme Court's explication in *Unitrin*.

> In assessing the role of *Blasius*, it is necessary to distinguish between board action that purposefully interferes with the exercise of shareholder voting rights (a) in circumstances unrelated to a tender offer or other contested acquisition (for example, a contested annual meeting to elect directors) and (b) in circumstances where an acquirer launches both a tender offer and a proxy fight to remove the board to facilitate the offer. In the former context the *Blasius* analysis would normally be applied in "free standing" form. However, in the latter context, the board action will "necessarily [invoke] both *Unocal* and *Blasius*" because both tests "recognize the inherent conflicts of interest that arise when shareholders are not permitted free exercise of their franchise." In these circumstances, a board's unilateral decision to adopt a defensive measure "touching upon issues of control" that "purposefully disenfranchises its shareholders" will be evaluated under *Unocal*. However, even within that framework that board decision will be viewed as "strongly suspect . . . and cannot be sustained without a 'compelling justification.'"[147]

Applied to the present case, the "free standing" or pure *Blasius* test is inappropriate because a tender offer and proxy contest have been coupled together. Thus, the vice-chancellor's comments indicate that this case is one which implicates both *Blasius* and *Unocal/Unitrin*, or the *Unocal/Unitrin* framework alone.[148]

Building upon this conclusion, the vice-chancellor then attempted to distinguish situations calling for a hybrid analysis[149] from those that demanded only the application of the *Unocal/Unitrin* test. To this end, the court identified two classes of cases in which both *Blasius* and *Unocal/Unitrin* have been applied:

> [B]oard action found to constitute inequitable conduct relating to a shareholder vote, had the effect (and, in some cases, also the intent) of either (i) precluding effective shareholder action (as in *Schnell*, where a stockholders

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[147] *Kidsco*, No. 14,649, 1995 Del. Ch. LEXIS 152, at *37-38 (quoting *Stroud*, 606 A.2d at 92 n.3).

[148] *Id.* at *38.

[149] By the term "hybrid analysis," reference is made to those cases which implicate both *Blasius* and *Unocal/Unitrin*. *See supra* text accompanying note 147.

> meeting was moved forward at the end stage of a proxy contest for control; as in *Lerman*, where an adopted by-law precluded the nomination of an opposing slate, and as in *Blasius*, where the board filled two newly created directorships with board nominees), or of (ii) "snatching victory from an insurgent slate on the eve of the noticed meeting" (as in *Aprahamian*, where a stockholder meeting was moved back near the conclusion of a proxy contest).[150]

The court distinguished these situations from the actions of the TLC board. According to the court, the bylaw amendment had neither the purpose nor the effect of impeding the franchise because it acted only to give the board time to "explore and develop other options if the Broderbund deal were rejected."[151] Moreover, the vice-chancellor reasoned, "[T]he by-law amendment would not *preclude* a shareholder vote on the directors' continued incumbency, but only delay by 25 days a stockholders meeting that on November 6 had neither been called nor legally demanded."[152]

Having concluded that the *Unocal/Unitrin* framework was the only applicable test, the court evaluated the board's response for proportionality. Parroting much of its language under the hybrid *Blasius* test, the court concluded unequivocally that the board's response to the threat was not draconian:

> The by-law amendment was not draconian because it only delayed, but did not preclude, a shareholder vote. And the 25 day delay clearly fell within a range of reasonable alternatives. . . . That response did not preclude SoftKey's ability to call a special meeting, nor could it alter or influence the vote in any respect. The by-law amendment simply preserved an opportunity for TLC's board, if the Broderbund merger were rejected by the stockholders, to fulfill its duties to the shareholders to seek the best value reasonably available.[153]

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[150] *Kidsco*, No. 14,649, 1995 Del. Ch. LEXIS 152, at *39 (quoting Stahl v. Apple Bancorp, Inc., 579 A.2d 1115, 1123 (Del. Ch. 1990)).

[151] *Id.* at *40.

[152] *Id.*

[153] *Id.* at *43-44.

Further, the court determined that the board's conduct also could not be condemned as outside the range of reasonable responses available to the board in this situation.[154]

Although the outcome of the case seems sound, the court's language reveals a basic defect in the analysis used to reach that point. The court draws on the same operative facts both for its conclusion that the hybrid *Blasius* analysis is inapplicable as it does for the conclusion that the bylaw amendment was not draconian as used in *Unocal/Unitrin*. For instance, per *Blasius*, the court remarks that the conduct did not impermissibly interfere with the shareholder franchise because it "would not *preclude* a shareholder vote on the directors' continued incumbency . . . ."[155] Yet, for the very same reason, the court in large part concludes that the bylaw amendment was not draconian: "[I]t only delayed, but did not preclude a shareholder vote."[156] Thus, the court's attempt to draw finer and finer distinctions between degrees and types of board conduct appears to be without meaningful consequence to the shareholders affected.

What is to be gleaned from the chancellor's opinion is that draconian board action which interferes with the exercise of shareholder voting rights "will be viewed as 'strongly suspect . . . and cannot be sustained without a compelling justification.'"[157] Therefore, it matters little whether the *Blasius* or *Unitrin* label is affixed to the court's analysis. Under the rubric of either case, the court has indicated that board action which renders impotent the exercise of shareholder rights is not to be tolerated, except in the most extreme of circumstances.

There, however, are those who would persist in claiming that the cases to which *Blasius* and its "compelling justification" standard have been applied may be distinguished from the draconian responses to takeover threats addressed by *Unitrin*. They would direct attention to the actions of the board in *Blasius*, which directly manipulated the shareholder election machinery by expanding the size of the board.[158] Yet, the distinction pointed to is an essentially meaningless one, emphasizing form over substance. Board action is not *per se* more injurious to the rights of stockholders because it directly interferes with the exercise of shareholder voting rights instead of indirectly accomplishing the same result.

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[154] *Kidsco*, No. 14,649, 1995 Del. Ch. LEXIS 152, at *44.
[155] *Id.* at *40.
[156] *Id.* at *44.
[157] *Id.* at *38 (quoting *Stroud*, 606 A.2d at 92 n.3).
[158] *Blasius*, 564 A.2d at 652.

A comparison of *Kidsco* and *Unitrin* brings home this very point. In *Kidsco*, the board directly manipulated the electorate machinery by delaying a meeting of shareholders.[159] This action, however, was validated by the chancery court because it had neither the purpose nor the effect of significantly impeding the shareholder franchise and did not preclude the shareholder vote.[160] In contrast, consider the repurchase measure challenged in *Unitrin*. Although tentatively accepted by the court because it did not foreclose the outcome of the pending proxy battle, it is a simple matter of negative implication to realize that had the looming shareholder vote been rendered meaningless by the company's stock repurchases the court would have tagged it draconian.[161] Yet, this tactic did not directly manipulate the election machinery but only shifted the composition of the company's ownership.

In essence, with the lone exception noted above,[162] it appears that *Blasius*'s "compelling justification" standard has been subsumed within the *Unocal/Unitrin* framework. In other words, reliance on different labels, recognizing the different mechanisms by which board interference with the stockholder franchise may be effected, is no longer helpful if each tactic leads to the same result. As Shakespeare wrote, "An honest tale speeds best being plainly told."[163] In other words, if, as appears to be the case, direct manipulation of the shareholder franchise represents just another context in which board responses may be characterized as unreasonably preclusive or coercive, then perhaps it is best to label them all draconian and be done with it. Delaware's corporate jurisprudence would benefit from bringing a measure of clarity to this often confusing analysis.

B. *Non-draconian Responses*

Unitrin also presents a corollary question. If a defense is not draconian because it is neither preclusive nor coercive,[164] just what

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[159] *Kidsco*, No. 14,649, 1995 Del. Ch. LEXIS 152, at *14-18.

[160] *Id.* at *39-40, *44.

[161] *Unitrin*, 651 A.2d at 1388-89. Although expressing its tentative conclusion that the plan was not draconian, the supreme court remanded the case to the chancery court for a determination whether the repurchase plan "was, in fact, preclusive because American General's success would either be mathematically impossible or realistically unattainable." *Id.*

[162] As *Kidsco* suggests, the remaining application of *Blasius* in "free standing" form is "in circumstances unrelated to a tender offer or other contested acquisition . . . ." *Kidsco*, No. 14,649, 1995 Del. Ch. LEXIS 152, at *37.

[163] WILLIAM SHAKESPEARE, RICHARD III act IV, sc. 4.

[164] *See supra* text accompanying note 103 (defining draconian defenses).

considerations would remove it from the range of reasonableness?[165] In the decade spanned by *Unocal* and *Unitrin*, no Delaware court has struck down a defense as disproportionate absent a finding that it operated either coercively or preclusively on the firm's stockholders.[166] Thus, the question that necessarily arises is what non-draconian defenses would fail to satisfy the range of reasonableness parameters?

The simple answer may be that board action which is not draconian and, therefore, qualifies for "range of reasonableness" review will not be enjoined.[167] Since *Unocal*'s inception, commentators have argued that the test does not provide for consistent application.[168] The inexactitude of these standards, in turn, make a meaningful and refined proportionality analysis difficult.[169] Viewed in this light, the bifurcation of the proportionality query could act as a judicial recognition that when management induced coercion or preclusion are absent from the equation, the court can not and should not look so closely at the character of the target board's response.[170]

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[165]*See supra* text accompanying note 104 (defining the reasonableness standard for non-draconian defenses).

[166]*See supra* text accompanying note 118.

[167]*But see Moore Corp.*, 907 F. Supp. at 1563 ("Since the Court finds that the retention of the poison pill was not a coercive or preclusive response, it must merely be satisfied that it fell within a 'range of reasonableness' to survive *Unocal* scrutiny.") (quoting Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34 (Del. 1993)).

[168]*See, e.g.*, BRUDNEY & BRATTON, *supra* note 120, at 1129 (arguing the legal uncertainty of the standard and the failure to define clear workable standards); Alan E. Garfield, *Paramount: The Mixed Merits of Mush*, 17 DEL. J. CORP. L. 33, 33-34 (1991) (arguing the unclarity of the standard in the context of Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1989)).

[169]*See* BRUDNEY & BRATTON, *supra* note 120, at 1129-31. "[T]he opinions of Delaware (and other) courts do not go much distance in articulating workable substantive or procedural standards for judicial review of the propriety of defensive actions." *Id.* at 1129.

[170]This observation does not apply in instances in which it is apparent from the record that management is acting in its own entrenchment interest rather than in the good faith belief that such a response is warranted by a threat to the enterprise or its stockholders. Delaware courts have in the past invalidated such actions without regard to proportionality and should continue to do so despite this revision. *See, e.g.*, *Schnell*, 285 A.2d at 439 (holding that the management's attempt to use corporate machinery for the "purpose of perpetuating itself in office" is inequitable and, hence, impermissible).

Furthermore, even within the range of reasonableness inquiry, the court has retained for itself a certain degree of discretion. This discretion provides it with a safety valve to act should the case arise where the threat posed is truly minimal and the board reacts with severe responses. For instance, in *Grand Metro. Pub. Ltd.*, the court found that where the offer was fully financed, available to all shareholders, had been outstanding for a significant amount of time, and provided consideration that was generous, any threat present was negligible. *Grand Metro. Pub. Ltd.*, 558 A.2d at 1057-58. Therefore, a board's response resulting in a drastic drop in the corporation's value was not reasonable in relation to the threat. *Id.* at 1058, 1060.

V. CONCLUSION

It is too early to say with any degree of certainty what the Delaware Supreme Court's decision in *Unitrin* bodes for the future of Delaware law regarding takeovers. *Unitrin*'s bifurcation of *Unocal*'s proportionality review may represent no more than a restatement and clarification of existing precedent.[171] However, the alternative, which seems equally as plausible and consistent with the case law decided under *Unocal*'s rubric, is that *Unitrin* embodies a meaningful revision to proportionality review as either a per se rule against or as a heightened level of scrutiny of draconian responses. Its treatment of preclusively and coercively draconian defenses suggests a greater respect for shareholder choice, particularly in the exercise of the shareholder franchise.[172] Conversely, *Unitrin*'s limited "range of reasonableness" inquiry implicates greater discretion for directors, albeit within narrower confines.[173]

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Hopefully, were such an offer to present itself again, the court would reject severe defenses as outside the range of reasonableness even if they could not be characterized as draconian.

[171] *See supra* notes 101-09 and accompanying text.

[172] *See supra* part IV.A.

[173] *See supra* part IV.B.