THE LIFE AND ADVENTURES OF *UNOCAL* — PART I: MOORE THE MARRIER

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For over a dozen years now the Delaware Supreme Court's camp followers (the Court of Chancery, the corporate bar, and academics) have struggled with the consequences of *Unocal Corp. v. Mesa Petroleum Co.*[1] *Unocal* presented the issue of what standard would apply to judge whether board action by a takeover target company comported with the board's fiduciary duties. Traditionally, the Delaware courts had two standards they could use to judge whether a board met its fiduciary duties in taking some action. The problem with *Unocal* was that many thought the Delaware Supreme Court spoke as though it were adding a third standard to this world of alternatives without indicating how the new standard could be different from the other two.

The Court of Chancery and the Delaware Supreme Court immediately began a colloquy about the meaning of *Unocal*. Because *Unocal* developed through the medium of opinions issued as each takeover fight was litigated, camp followers tended to focus on the margins of *Unocal*, its incremental changes. Camp followers who took a bigger or longer view mostly did so thematically or doctrinally, attending to particular aspects or applications of the *Unocal* rule.

But reading the opinions chronologically, compressing the dozen years it took to create them down to the time it takes to read them, gives the colloquy an entirely different perspective. *Unocal* takes on attributes and characteristics, and it changes over time. In effect, the *Unocal* rule has a life of its own and, like the protagonist from an episodic novel, it has lived through a series of adventures which it both affected and was affected by.

My purpose is to trace this odyssey. I want to treat the rule that came from *Unocal* as a thing with a life of its own. My principal concern is neither takeovers nor Delaware corporate law nor even really the merits of the *Unocal* rule. Rather, I want to describe the conversation between the Chancellors and Justices, which continues today, that created and animates *Unocal*. This, then, is the life and adventures of *Unocal*.

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

I.

A. *You Know What Happens When You Assume, Don't You?*[2]

Let me first describe the legal question that the *Unocal* rule was designed to answer. The board of directors of a Delaware corporation is subject to two kinds of corporate law constraints whenever it acts. First, the action must be one permitted, or at least not forbidden, by the Delaware General Corporation Law.[3] Second, the directors must act in good faith, on the basis of all material information reasonably available, "and in the honest belief that the action taken [is] in the best interests of the company" and its shareholders.[4] This second constraint is usually referred to as the directors' fiduciary duties and is sometimes divided into the duty of care[5] (the duty to be adequately informed) and the duty of loyalty[6] (the duty to act in good faith and in the company's best interest).

A tyro might well assume that a plaintiff challenging a board action has the burden of proving, by a preponderance of the evidence, that the board violated one of these constraints. If the suit is based on the ground of statutory violation, the tyro would be right. This situation is hardly ever the case, though. The permissive nature of the Delaware General Corporation Law, its textual openness, and the close attention counsel pay to the statute combine to make such lawsuits almost certain losers. As a practical matter, plaintiffs attacking board actions usually claim that a board of directors breached one of its fiduciary duties.[7] Here, the tyro's assumptions about burdens of proof and the facts to be proved no longer hold.

The tyro would recognize that the judges are not business people, but might not appreciate that the consequence of this truism is that courts

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[2]Iterated by legions of athletic coaches everywhere to any athlete who reasons.

[3]DEL. CODE ANN. tit. 8 (1991).

[4]Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *reargument denied*, No. 6919, 1985 WL 21141 (Del. Ch. June 7, 1985).

[5]Smith v. Van Gorkom, 488 A.2d 858, 872-73 (Del. 1985). "[A] director's duty to exercise an informed business judgment is in the nature of a duty of care, as distinguished from a duty of loyalty." *Id.* "The determination of whether a business judgment is an informed one turns on whether the directors have informed themselves 'prior to making a business decision, of all material information reasonably available to them.'" *Id.* at 872

[6]Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993), *modified on reargument*, 636 A.2d 956 (Del. 1994). "[T]he duty of loyalty mandates that the best interests of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally." *Id.*

[7]*See, e.g., id.* at 350 (alleging "fraud, breach of fiduciary duty and unfair dealing"); *Van Gorkom*, 488 A.2d at 871 (alleging breach of duty of care).

will grant directors some deference when reviewing board decisions.[8] In this sense, the plaintiff goes to the post carrying weight. Sometimes, though, especially when it looks as if the directors may have taken liberties with the corporate fisc, courts will not defer and will give board actions the fish eye, placing the directors behind the eight ball.

The evidentiary presumptions under Delaware case law determine whether deference or the fish eye is to be accorded to directors' actions. These presumptions not only locate the burden on one party rather than the other, but they also change what it is that party must prove. Perhaps surprisingly, in no instance is a party required to show that the directors did or did not meet their fiduciary duties.[9]

When the directors' actions are accorded deference, the shareholder plaintiff must show that those actions cannot be attributed to any rational business purpose[10] or that the directors breached their duty of care. If the plaintiff claims the board did not meet its duty of care, the plaintiff must show that the directors failed to obtain all material information reasonably available and that this failure was grossly negligent.[11] When the court gives deference to the directors' action it says that the directors are entitled to the protection of business judgment rule.[12] Every board

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[8]*See Aronson*, 473 A.2d at 812.

[9]Shareholders cannot file a complaint against directors any time they think a suit is warranted. The courts early on recognized that in a corporation with any appreciable number of shareholders, at least one shareholder would object to almost any board of directors' action. So, the courts imposed a rule that shareholder would-be plaintiffs must first either make a demand on the board to sue themselves (on behalf of the corporation) or be prepared to demonstrate to the court that such a demand would be futile because the directors would not bring such a suit regardless of its merits. *See, e.g.*, DEL. CH. CT. R. 23.1 (setting forth the demand requirements in Delaware). Conceptually, this demand rule was rooted in the statutory grant that all corporate powers are vested in the board. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (1991) (setting forth the statutory grant in Delaware). The theory of the plaintiff's complaint is deemed to be that the corporation has been injured by some action (i.e., the board decision in question) and that the corporation, through its board, should redress that harm. When the harm is caused by a third party, the board ordinarily will act with some alacrity in redressing the harm. When the harm is caused by the board itself, though, it is easy to see why the board may be reluctant to bring suit. The demand requirement as a governor that regulates the number of shareholder suits is probably a necessary rule. The consequence of that rule is that plaintiffs rarely succeed on the merits if demand is not held to be futile.

[10]Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).

[11]Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

[12]*See* Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 360-61 (Del. 1993) (describing the business judgment rule). The business judgment rule is grounded in the underlying principle that a corporation is managed by its board of directors. *Id.* From this premise the rule serves to prevent a court from unreasonably intruding upon the decisions of a board of directors. *Id.* Unless a board's actions appear irrational, its decisions will not be overturned unless the plaintiff "provid[es] evidence that [the] directors . . . breached any one of the *triads*

transaction is accorded the protection of the business judgment rule, in a sense, because the court's analysis begins with the assumption that it attaches.[13]

On the other hand, when the fish eye comes into play, the director-defendants must show "the most scrupulous inherent fairness of the bargain."[14] For example, a plaintiff can rebut the business judgment rule presumption by showing in the complaint that the directors may not have been independent, in other words that they may have violated their duty of loyalty.[15] The most obvious examples of this occur where the directors stand to profit personally from a proposed transaction or where the directors are connected with another company that may be affected by a proposed transaction.[16] A court's determination to give the fish eye is said to invoke the intrinsic or entire fairness standard.[17]

B. *Another Fine Mess*

This binary world, of either according deference or giving the fish eye to directors' actions, worked perfectly well for quite some time. However, troubles began in the mid-1960s with the Delaware Supreme

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of their fiduciary duty — good faith, loyalty or due care." *Id.* at 361.

[13]The business judgment rule is a "presumption that in making a business decision the directors of a corporation acted on an informed basis [i.e., with due care], in good faith and in the honest belief that the action taken was in the best interests of the company." *Aronson*, 473 A.2d at 812. The party challenging a decision bears the burden of rebutting this presumption. *Id.*

[14]Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).

[15]Many commentators divide this showing into two aspects, one focusing on the objective question whether the directors had any incentive not to act in the best interest of the corporation and its shareholders and the other focusing on the subjective question of the directors' good faith. In my view, unless the board was literally irrational when it acted, a situation I find virtually impossible, the board cannot act in subjective bad faith unless it was faced with an objective incentive not to act in its beneficiaries' best interest. Compare Chancellor Allen's description of the business judgment rule's "escape hatch" in West Point-Pepperell, Inc. v. J.P. Stevens & Co. (*In re* J.P. Stevens & Co. Shareholders' Litig.), 542 A.2d 770 (Del. Ch.), *appeal refused*, 540 A.2d 1088 (Del. 1988) [*J.P. Stevens*], with *supra* text accompanying note 155. I am unaware of any Delaware case in which such an incentive was first discovered *at trial*. So, the practical possibility of a plaintiff showing bad faith at trial without showing a board incentive to disregard the best interest of the beneficiaries before trial seems remote. I believe the best way to think about this requirement is to conceptualize it entirely in terms of whether the board had a reason to act other than in the best interest of the company and its shareholders.

[16]*Weinberger*, 457 A.2d at 710.

[17]*See Cede*, 634 A.2d at 361 (stating that "[i]f the [business judgment] rule is rebutted, the burden shifts to the defendant directors . . . to prove to the trier of fact the 'entire fairness' of the transaction to the shareholder plaintiff").

Court's decision in an early greenmail case, *Cheff v. Mathes*.[18] In *Cheff*, the Holland Furnace Company board unanimously[19] voted to repurchase about 17.5% of the company's shares that were owned by Arnold H. Maremont. Mr. Maremont, who had a reputation for purchasing and liquidating companies, had made a demand for a board seat.[20] The repurchase price was some 31%, or $525,000, more than the market price of those shares on the day before the repurchase.[21]

An interesting fact, known to only four of the seven directors, was that one of the directors, Katherine Cheff, intended to purchase Mr. Maremont's shares personally if the Holland Furnace Company did not do so.[22] The Court of Chancery held those four directors liable in a shareholder derivative action and dismissed the complaint against the three directors who were unaware of Mrs. Cheff's intentions.[23] The plaintiffs elected not to appeal the dismissal against the three ignorant directors, so the Delaware Supreme Court considered only the appeal by the four culpable defendants and reversed.[24]

In addressing the burden of proof, the Delaware Supreme Court limned an elliptical logic that, twenty years later, provided a basis for *Unocal*. Justice Carey noted that the directors have the burden of justifying the use of corporate funds to repurchase stock when the consequence of this transaction is to maintain control of the corporation.[25] This burden should be placed on the directors because of the inherent conflict they face.[26] In describing this burden, Justice Carey made a distinction between the two directors who received only director fees and the two who, in addition, received substantial salaries. As to the former defendants, the court opined, "[W]hile called upon to justify their actions,

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[18]199 A.2d 548 (Del. 1964).

[19]The board voted six to zero on the repurchase. One of the seven directors was absent. Mathes v. Cheff, 190 A.2d 524, 528 (Del. Ch. 1963), *rev'd*, 199 A.2d 548 (Del. 1964).

[20]*Cheff*, 199 A.2d at 552.

[21]*Mathes*, 190 A.2d at 528.

[22]*Cheff*, 199 A.2d at 552.

[23]*Mathes*, 190 A.2d at 530.

[24]*Cheff*, 199 A.2d at 553, 557. The court reversed on the ground that the defendants legitimately believed that Mr. Maremont posed a threat to the continued existence of Holland Furnace in its present form. *Id.* at 556. This belief made using corporate funds to repurchase the shares legal regardless of the absolutely costless (to Holland Furnace) alternative. *Id.* at 556-57.

[25]*Id.* at 554. The court noted that "if the board has acted solely or primarily because of the desire to perpetuate themselves in office, the use of corporate funds . . . is improper." *Id.*

[26]*Id.* (citing and quoting Bennett v. Propp, 187 A.2d 405, 409 (Del. 1962): "'Hence, in our opinion, the burden should be on the directors to justify such a purchase as one primarily in the corporate interest.'").

[they] will not be held to the same standard of proof required of those directors having personal and pecuniary interest in the transaction."[27] But then, having divided the defendants into two groups, Justice Carey ignored this distinction throughout the opinion, treating the four defendants identically.[28]

The most likely explanation for Justice Carey's distinction is that he simply meant that the defendants who received only director fees would have a much easier time discharging their burden than would the directors who had substantial salaries at stake. From the context, and from the court's treatment of the directors as a group, I assume that Justice Carey did not mean that the directors would face different tests depending on whether they received any remuneration above their director fees.

Cheff provided one necessary ingredient for *Unocal*. *Pogostin v. Rice*,[29] decided two decades after *Cheff* and only one year before *Unocal*, furnished the second. In *Pogostin*, the City Investing Company board had rejected a tender offer at a tremendous premium over the current market price and so faced a shareholder derivative suit.[30] Justice Moore held, without any discussion, that the business judgment rule attached to board actions in the takeover context.[31] He supported his statement with six case citations[32] — only one of which was relevant to the point.[33] The

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[27]*Id.* at 554-55.

[28]Justice Carey phrased the issue as follows:

> The question then presented is whether or not *defendants* satisfied the burden of proof of showing reasonable grounds to believe a danger to corporate policy and effectiveness existed by the presence of the Maremont stock ownership. It is important to remember that *the directors* satisfy their burden by showing good faith and reasonable investigation; *the directors* will not be penalized for an honest mistake of judgment, if the judgment appeared reasonable at the time the decision was made.
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> Accordingly, we are of the opinion that the evidence . . . leads inevitably to the conclusion that *the board of directors*, . . . believed, with justification, that there was a reasonable threat to the continued existence of Holland, or at least existence in its present form, by the plan of Maremont to continue building up his stock holdings.

Cheff, 199 A.2d at 555-56 (emphasis added).

[29]480 A.2d 619 (Del. 1984).

[30]*Id.* at 622. The City Investing board rejected a tender offer of $32.50 per share versus a recent trading price of $20 per share. *Id.*

[31]*See id.* at 627.

[32]*Id.*

[33]*See* Panter v. Marshall Field & Co., 646 F.2d 271, 295 n.7 (7th Cir.), *cert. denied*, 454 U.S. 1092 (1981). In that opinion, Judge Pell did hold that Delaware would apply the business judgment rule to evaluate takeover defensive actions. *Id.*

other five cases either stated that the business judgment rule applies to board actions initially but that plaintiff can sometimes trigger the entire fairness standard, or they talked about the business judgment rule generally.[34]

It was obvious to any corporate lawyer that the standard for reviewing target company defensive measures would be critical to whether target boards had greater or lesser leeway to resist unwanted takeover bids. By the time of the *Pogostin* decision in mid-1984, the takeover wave that began in the late 1970s was in full flower.[35] Nonetheless, it appears from the text of the opinion that the Delaware Supreme Court decided this central issue without, apparently, giving the matter much thought. This major holding consisted of only one sentence and was not required by prior Delaware law.[36] To West Publishing Company, this holding did not even rate a headnote.[37]

II.

A. *Sometimes You Get a Second Chance to Make a First Impression*

Unocal was the result of an unwanted takeover attempt by T. Boone Pickens' Mesa Petroleum Company in the spring of 1985.[38] Mesa made a cash tender offer for just over half of the Unocal shares that, if successful, was to be followed by a merger in which the remaining Unocal shares would be converted into junk bonds.[39] In response, Unocal announced a contingent exchange offer.[40] Should Mesa's tender offer

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[34]*See* Buffalo Forge Co. v. Ogden Corp., 717 F.2d 757, 759 (2d Cir.), *cert. denied*, 464 U.S. 1018 (1983); Treadway Cos. v. Care Corp., 638 F.2d 357 (2d Cir. 1980); Crouse-Hinds Co. v. Inter-North, Inc., 634 F.2d 690 (2d Cir. 1980); Johnson v. Trueblood, 629 F.2d 287 (3d Cir. 1980), *cert. denied*, 450 U.S. 999 (1981); Gimbel v. Signal Cos., 316 A.2d 599 (Del. Ch.), *aff'd*, 316 A.2d 619 (Del. 1974).

[35]The 1980's style hostile takeover began in the summer of 1974 when Morgan Stanley & Company, an old line Wall Street investment banking house, agreed to help International Nickel Company of Canada take over ESB, Inc. *See* JOHN BROOKS, THE TAKEOVER GAME 1-5 (1987).

[36]*Pogostin*, 480 A.2d at 627 ("What we said there [in Aronson v. Lewis, 473 A.2d 805, 812-16 (Del. 1984), that the business judgment rule was generally available] is equally applicable here in the context of a takeover.").

[37]*See Pogostin*, 480 A.2d at 619-21.

[38]Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 951 (Del. 1985).

[39]*Id.* at 949-50. More precisely, Mesa owned about 13% of Unocal's shares and was tendering for about 37% more, which would give it just over 50%. *See id.* at 949. To investors, Mesa's tender offer was in effect offering cash for 43% of their shares and junk bonds for 57%.

[40]*Id.* at 951.

succeed, Unocal shareholders could exchange their shares for a higher amount of debt than would be offered in the Mesa merger.[41]

Unocal's intention was to stymie Mesa's takeover by preventing the initial tender offer from succeeding. Unocal rightly believed that shareholders would prefer Unocal's exchange offer to the junk bonds under Mesa's merger. But, unless enough shares were tendered initially to give Mesa a majority, Mesa would not buy any shares and neither its merger nor Unocal's exchange offer would be effected.[42] One key to the

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[41] *Id.*

[42] This analysis is a form of the prisoner's dilemma. More specifically, the possible outcomes for each shareholder were (from most desirable to least desirable):

1. $72 per share in Unocal debt, to be received by not tendering into Mesa's tender offer but accepting Unocal's exchange offer;
2. $54 per share in cash for 43% of one's shares from Mesa's tender offer and $72 per share in Unocal debt for 57% of one's shares from the Unocal exchange offer;
3. $54 per share in cash for 43% of one's shares from Mesa's tender offer and $54 per share in junk bonds for 57% of one's shares from Mesa's merger; and
4. $38 per share if Mesa's tender offer were not consummated and the price of Unocal fell back to its pre-tender offer level.

See Robert J. Cole, *New Tactic as Unocal Hits Back*, N.Y. TIMES, Apr. 17, 1985, at D1.

The actual value of the junk bonds and Unocal debt was subject to some conjecture, because no market for any of those securities had developed, however, the $72 per share in Unocal debt was surely more valuable than the $54 per share in junk bonds. The dilemma arises from the collective action and free rider problems. Shareholders can receive the best outcome for themselves only by not tendering into Mesa's tender offer. But, if the tender offer fails because no one tenders, all shareholders will receive the worst outcome. So, it would be to the advantage of all for each shareholder to tender into Mesa's tender offer and then accept the Unocal exchange offer. With 70,000 shareholders of record, Mesa Petroleum Co. v. Unocal Corp., No. 7997, 1985 Del. Ch. LEXIS 411, at *3 (Del. Ch. May 13, 1985) [*Mesa II*], *rev'd*, 493 A.2d 946 (Del. 1985), the shares were widely enough held so that shareholders would not be able to act in concert, raising the free rider possibility that each shareholder would hope the others do the "right" thing while he or she could wait and exchange all his or her shares in the Unocal exchange offer.

Unocal's exchange offer plan worked too well. Unocal's investment banker, Goldman Sachs & Company, advised the company to waive the contingency for at least some of the shares because large shareholders would be upset if no transaction were consummated and the price fell to its pre-exchange offer levels of around $49. *See Unocal*, 493 A.2d at 951; Fred R. Bleakley, *Investors Balk at Unocal Bid*, N.Y. TIMES, Apr. 19, 1985, at D1. Presumably, risk arbitragers had purchased the vast majority of shares not owned by Mesa, probably at prices between $30 and $49, where it traded when the exchange offer began. *See Mesa II*, 1985 Del. Ch. LEXIS 411, at *21-24; Vartanig G. Vartan, *Arco Favored by Analysts*, N.Y. TIMES, Apr. 26, 1985, at D8. Unocal surely did not want to risk having significant amounts of its stock in the hands of disaffected shareholders who would be only too happy to sell out (and quickly) to another raider. Therefore, Unocal offered to exchange about one-third of the shares not owned by Mesa for $72 per share in Unocal debt. *See Mesa II*, 1985 Del. Ch. LEXIS 411, at *9.

success of Unocal's plan was that Mesa had to be excluded from the exchange offer.[43] If Mesa could exchange its Unocal shares, Unocal would, in effect, be financing its own takeover.[44] Mesa sought a temporary restraining order (TRO) and preliminary injunction in the Delaware Court of Chancery.[45]

Vice-Chancellor Berger held that the business judgment rule, while applicable to Unocal's decision to oppose Mesa's takeover attempt, was inapplicable to Unocal's selective exchange offer.[46] Rather, the entire fairness standard should apply to the selective repurchase because the shareholders were being treated unequally.[47] As a result, Vice-Chancellor Berger entered a TRO on the factual finding that the Unocal board was unlikely to meet its burden of showing entire fairness.[48]

Vice-Chancellor Berger's implicit harmonization of *Cheff* and *Pogostin* seems unremarkable. *Pogostin* did not hold that the business judgment rule always displaced the entire fairness standard in takeover settings. It simply held that takeover contexts, by themselves, were insufficient to trigger the entire fairness standard.[49] Vice-Chancellor Berger herself must have recognized this because she declined to certify her ruling for an interlocutory appeal on the grounds that her decision was neither a legal issue of first impression nor a matter on which the decisions of the Court of Chancery were in conflict.[50]

The Delaware Supreme Court disagreed with Vice-Chancellor Berger's conclusion that the case did not present an issue of first impression — probably the issue whether the takeover setting changed a corporation's power to purchase its stock selectively (and perhaps, what presumption should be applied to such a repurchase).[51] Nonetheless, the

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[43]*Unocal*, 493 A.2d at 951.

[44]*Id.*

[45]*Id.*

[46]*See* Mesa Petroleum Co. v. Unocal Corp, No. 7997, 1985 Del. Ch. LEXIS 423, at *4-9 (Del. Ch. Apr. 29, 1985) [*Mesa I*] (refusing to depart from the governing principles of fiduciary obligations and concluding that "The Mesa Exclusion" went beyond that of justifiable "defensive maneuvering").

[47]*Id.*

[48]*Id.* at *7-9.

[49]*See* Pogostin v. Rice, 480 A.2d 619, 626-27 (Del. 1984).

[50]*Unocal*, 493 A.2d at 952; DEL. SUP. CT. R. 42(b).

[51]I say "probably" because the published record is not absolutely clear. *Unocal* says only that Vice-Chancellor Berger did not believe the case presented a question of first impression but that the Delaware Supreme Court disagreed. *Unocal*, 493 A.2d at 952. Vice-Chancellor Berger's preliminary injunction opinion evidences some uncertainty on her part as to exactly what the supreme court thought was the issue of first impression:

> Justice Moore's Order [of May 2, 1985 finding the TRO ruling to be appealable] indicates that the validity of Unocal's exchange offer as a

supreme court declined to hear the TRO appeal, preferring to wait until Vice-Chancellor Berger ruled on the preliminary injunction motion, which she did ten days later.[52] On an enhanced factual record, Vice-Chancellor Berger reached the same legal conclusions and made the same factual findings. That is, she held that the entire fairness standard applied to the selective repurchase[53] and found that Mesa would probably be successful on the merits.[54] Vice-Chancellor Berger granted the preliminary injunction against the selective exchange offer but this time certified her Order for interlocutory appeal as a question of first impression, which was accepted by the supreme court.[55]

B. *Caveat Auditor*

Scholars and practitioners have spent a dozen years searching the *Unocal* opinion for clues about the Delaware Supreme Court's intentions. Curiously, none of them have looked to the transcript of the oral decision[56] for guidance. While I appreciate that the oral decision is

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> defensive technique is a question of first impression in Delaware. In so doing, the Supreme Court *appears* to be recognizing that the line of authorities permitting other defensive maneuvers under the business judgment rule did not involve corporate action where the raider was treated unfairly *vis[-]à[-]vis* the other shareholders.

Mesa II, 1985 Del. Ch. LEXIS 411, at *15 (emphasis added).

Further, *Unocal* begins by stating that "[w]e confront an issue of first impression in Delaware — the validity of a corporation's self-tender for its own shares which excludes from participation a stockholder making a hostile tender offer for the company's stock." *Unocal*, 493 A.2d at 949.

[52]*Unocal*, 493 A.2d at 952.

[53]The Vice-Chancellor so held on the ground, which she relied upon before, that the shareholders were being treated unequally and upon the additional ground that the directors, who could participate as shareholders in the selective repurchase, were receiving a benefit not available to all shareholders. *Mesa II*, 1985 Del. Ch. LEXIS 411, at *17.

[54]*Id.* at *18-26.

[55]*Unocal*, 493 A.2d at 953.

[56]Unocal Corp. v. Mesa Petroleum Co., [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,046, at 91,210 (Del. May 17, 1985) [*Unocal* Oral Decision]. As it frequently does in takeover cases, the Delaware Supreme Court announced its *Unocal* decision orally shortly after argument. *Id.* at 91,210; *see also* Mills Acquisition Co. v. Macmillan, Inc., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,072, at 91,024-25 (Del. Nov. 2, 1988) [*Macmillan* Oral Decision]; Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,357 (Del. Nov. 1, 1985) [*Revlon* Oral Decision]; Paramount Communications, Inc. v. Time Inc. (*In re* Time Inc. Shareholder Litig.), 571 A.2d 1140, 1142 (Del. 1990) (noting that after briefing and oral argument, the supreme court, "in a brief ruling from the bench," determined "that the decision below should be affirmed").

superseded by the written opinion, the oral decision may nevertheless distill the court's analysis in a way that may be enormously helpful. The *Unocal* oral decision reveals that the supreme court did not intend to announce a new standard by which to measure director actions. Instead, it was content to rely on the traditional dichotomy of business judgment rule and intrinsic fairness.

In the oral decision, the court, literally speaking through Justice Moore, based its reversal entirely on the business judgment rule, following *Pogostin*.[57] After a précis of the facts, Justice Moore noted that the Vice-Chancellor had applied the intrinsic fairness standard but said that she had "distinguishe[d] certain Delaware cases" that permitted selective dealings with shareholders.[58] Because the Unocal board had a majority of outside directors who were unanimous in their recommendation:

> we start with the principle announced in [*Pogostin*] that the availability, function, and operation of the business judgment rule including the standards by which director conduct is judged, is applicable in the context of a takeover. Provided the decision is an informed one and absent a primary purpose of self-perpetuation in office, fraud, overreaching or lack of good faith, the directors' actions in meeting a takeover threat are valid exercises of business judgment and entitled to the respect accorded them by the business judgment rule.[59]

Justice Moore accepted the Vice-Chancellor's findings that the board acted in good faith, on an informed basis, and with the reasonable inference that Mesa might attempt greenmail.[60] With those premises, the supreme court was unable to conclude that the directors had breached any duties.[61] Accordingly, the court found the board's decision protected by the business judgment rule.[62]

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[57]*Unocal* Oral Decision, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,046, at 91,211.

[58]*Id.*

[59]*Id.*

[60]*Id.*

[61]*Unocal* Oral Decision, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,046, at 91,211.

[62]*Id.*

C. Unocal *on the Half Shell*

If the written opinion in *Unocal* had simply fleshed out the logic limned in the oral decision, a dozen years of discussion and debate would have gone by the boards. Instead, Justice Moore's written opinion differed in important ways from the logic of his oral decision and in so doing raised the questions that breathed life into *Unocal.*

Justice Moore began his analysis by finding that a selective repurchase is permitted under the broad language of sections 141(a) and 160(a) of the Delaware General Corporation Law[63] and from some sort of inherent duty (as though the general grant of corporate power to the board under section 141(a) were not inherent enough[64]) to protect the corporation from harm.[65] Justice Moore next reaffirmed the *Pogostin* holding that the business judgment rule applies in takeover situations and elaborated slightly on the rationale, stating that a board is bound by its fiduciary duties whenever it acts, including its acts in response to a takeover bid.[66]

To this point, Justice Moore's opinion is consistent with his Oral Decision. But while the business judgment rule applies, "certain caveats" must be met before the presumption attaches.[67] These caveats are rooted in the "omnipresent specter" that the directors may be acting to preserve their own board positions and involve, among other things, placing a burden on the defendants.[68] Justice Moore quoted, as Justice Carey did in *Cheff*, the language in *Bennett* that gives the *raison d'être* for putting the burden on defendants when control is an issue: "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

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[63]DEL. CODE ANN. tit. 8, §§ 141(a), 160(a) (1991).

[64]"The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors . . . ." *Id.* § 141(a).

[65]Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953-54 (Del. 1985).

[66]*Id.* at 954. "In that respect a board's duty is no different from any other responsibility it shoulders, and its decisions should be no less entitled to the respect they otherwise would be accorded in the realm of business judgment." *Id.* Justice Moore twice more makes clear that the standard is the business judgment rule. "As this Court has previously noted, [the fact that some directors are large stockholders] does not create a disqualifying 'personal pecuniary interest' to defeat the operation of the business judgment rule." *Id.* at 958 (quoting Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964)). After noting that the board had statutory power to effect a selective repurchase and that the board's response was reasonable in relation to the perceived threat, Justice Moore said, "Under those circumstances the board's action is entitled to be measured by the standards of the business judgment rule." *Id.*

[67]*Id.* at 954.

[68]*Id.*

involved. The directors are of necessity confronted with a conflict of interest, and an objective decision is difficult."[69] What Justice Moore did not do, unlike Justice Carey, was continue the quote which explains the consequence of this omnipresent specter: "Hence, in our opinion, the burden should be on the directors to justify such a purchase as one primarily in the corporate interest."[70]

This omission in *Unocal* might be of no import since the directors under *Unocal* do have a burden placed on them. But Justice Moore then described the consequence of this director conflict by holding that the directors must show, not entire fairness, but, by their good faith and reasonable investigation, that they had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed because of another person's stock ownership."[71] Justice Moore cited *Cheff* for this requirement. This seems to be a narrower and easier task for the directors than showing that the transaction was entirely fair. It surely is a change from *Cheff*, which pretty clearly indicated that the directors needed to show entire fairness.[72]

But, Justice Moore then went on to say that the *Cheff* test "is designed to ensure that a defensive measure [in a takeover setting] is indeed motivated by a good faith concern for the welfare of the corporation and its stockholders."[73] This language sounds like the point of the entire fairness standard. So, this first caveat to the application of the business judgment rule *could* be the entire fairness standard, or it *could* be a test that is equivalent to the entire fairness standard, or it *could* be a test that is not the entire fairness standard at all.

Meeting the test derived from *Cheff* was only the beginning, though Justice Moore's second caveat, and the part of *Unocal* that created the most interest at the time, was the section adopting a so-called proportionality test in addition to the test based on *Cheff*. After the board shows that it reasonably perceived a danger, the court must then find that the board's action was reasonable in relation to the perceived threat.[74] Justice Moore neither supported this test with a citation nor was he

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[69]Bennett v. Propp, 187 A.2d 405, 409 (Del. 1962).

[70]*Id.*

[71]*Unocal*, 493 A.2d at 955 (citing Cheff v. Mathes, 199 A.2d 548, 554-55 (Del. 1964)).

[72]*See Cheff*, 199 A.2d at 556 (noting that "[the Vice-Chancellor's] decision is inconsistent with his finding that the motive was improper, *within the rule enunciated in [Bennett]*", and "if the actions were proper because of a decision by the board made in good faith that *the corporate interest was served thereby*, [then the decision is valid]") (emphasis added)).

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

[74]*Id.*

explicit that this is a wholly new requirement (if it is). Further, he did not locate this requirement in relation to the business judgment rule (except that it is the second caveat that is a predicate) or the entire fairness standard (except to say that it is the second caveat that is a predicate to the business judgment rule).[75]

Again, as with the first caveat, this proportionality test *could* be the entire fairness test or it *could* be functionally identical to entire fairness or it *could* be something different. When Justice Moore describes the inquiries the board must make to support a finding of proportionality, however, they sound very much like entire fairness. *Unocal* says that a board, in determining a proportionate response, must consider "inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on 'constituencies' other than shareholders . . ., the risk of nonconsummation, and the quality of securities being offered in the exchange."[76] Two years before *Unocal*, Justice Moore described the entire fairness standard as involving:

> 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. . . . [T]he economic and financial considerations . . . 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.[77]

If the directors can satisfy this second caveat as well, they are, at last, entitled to the business judgment rule presumption.[78] So, with *Unocal*, target board action in the takeover setting will be judged by the business judgment rule, but not at first. Instead, the directors must first demonstrate, through good faith and reasonable investigation, that they had reasonable grounds to believe that a danger to corporate policy and effectiveness existed. Then, they must show that their action was

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[75] *Id.*

[76] *Id.*

[77] Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983).

[78] *Unocal*, 493 A.2d at 958. After noting that the board had statutory power to effect a selective repurchase and that the board's response was reasonable in relation to the perceived threat, Justice Moore said, "Under those circumstances the board's action is entitled to be measured by the standards of the business judgment rule." *Id.*

reasonable in relation to the threat posed. If they make those showings, they are then entitled to the business judgment rule presumption.

One question that arises is whether Justice Moore's written opinion really was different from the oral decision. In other words, did the supreme court change its analysis or did listeners simply miss the import of Justice Moore's words? In the course of his oral decision, Justice Moore made two related observations that perhaps presaged the written opinion. First he said, "While we believe that the business judgment rule generally is applicable to defensive measures . . ., the responses of the board to the perceived threat must be judged at the outset by the nature of the threat itself."[79] This comment can, of course, be seen as foreshadowing the proportionality test, but it would more naturally be seen as an observation that, in assessing whether the plaintiff has shown that the board's action cannot be attributed to any rational business purpose, a court must consider the events that precipitated the board's action. In that light, Justice Moore's remark is simply axiomatic as to the nature of the court's inquiry under the business judgment rule.

The surrounding remarks also lend credence to this interpretation. Justice Moore had just said that Mesa contended that the business judgment rule was inapplicable because of the disparate treatment under the exchange offer.[80] After his comment about measuring the board's response he described the threat the board saw in Mesa's tender offer and concluded that a characteristic of the business judgment rule is deference to a board decision unless it cannot be attributed to any rational business purpose.[81]

Later he added a second observation that might be seen as anticipating the proportionality test,

> While we caution boards . . . that they do not have unbridled discretion to defeat any perceived threat to corporate control by any Draconian means available, we are satisfied that in the context of this inadequate tender offer Unocal's action is not so irresponsible and unjustified as to remove it from the ambit of the business judgment rule.[82]

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[79] *Unocal* Oral Decision, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,046, at 91,211 (Del. May 17, 1985).

[80] *Id.*

[81] *Id.*

[82] *Id.* at 91,212.

This second comment, too, seems more consonant with the business judgment rule than with trying to hint at a change in the legal standards. A straightforward interpretation has Justice Moore warning boards not to assume that any action is permissible simply because it will be scrutinized under the business judgment rule.

The central question the Court of Chancery had to grapple with was whether the Delaware Supreme Court really meant to establish a third standard of review. If the court did not mean what it said, then, as a functional matter, either the business judgment rule or the entire fairness standard applied to takeover target board decisions. If so, which one was the court really implying was the appropriate test, or did the business judgment rule apply to some takeover decisions and entire fairness apply to other takeover decisions?

If the Delaware Supreme Court really did mean to establish a different test in *Unocal*, then its decision raised several further questions both practically and theoretically critical. In answering these questions, it would be extraordinarily helpful to know why the supreme court felt it necessary to establish this third test. What was lacking about business judgment or entire fairness that made them unsuitable for takeover settings?

Among the questions raised by believing that *Unocal* was meant to set up a third standard are: First, how, exactly, is *Unocal* functionally different from the entire fairness standard? Obviously the words the court used in describing *Unocal* are different from those it used to describe entire fairness.[83] But there are similarities. For example, the burden has been shifted to the defendants in both standards, and the differences need not translate into different results. Second, what happens if the board does not make the preliminary showings? Are their actions then judged by entire fairness or are they automatically impermissible? Finally, if a board meets the *Unocal* predicate, how can a plaintiff ever prevail? In theory, once *Unocal* has been satisfied it is open to the plaintiff to show by a preponderance of the evidence that the directors' decisions were primarily based on perpetuating themselves in office or some other breach of fiduciary duty.[84] Practically, how can a plaintiff make such a showing when the board has legitimately found a threat and taken action that is reasonable in relation to that threat?

I believe the most compelling explanation for the *Unocal* test is that the court made an unconsidered choice in *Pogostin* that it quickly regretted but that it was unwilling to admit and rectify in *Unocal* because

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[83]*See supra* notes 71-76 and accompanying text.

[84]*See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958 (Del. 1985).

it was decided less than a year after *Pogostin*. Two of the three Justices in *Pogostin*, Justices McNeilly and Moore, were also assigned to *Unocal*.[85] Although the collegial dynamics must remain obscure to an outsider, at some point during the three and a half weeks between the Oral Decision and the written opinion these two Justices, probably in some consultation with Judge Taylor, may have decided to hew to *Pogostin* formally while backing away from its holding that the business judgment rule applies to takeover defenses.

Why not overrule, distinguish, or simply elide over *Pogostin*? One answer is that Justices Moore (who wrote *Pogostin* and *Unocal*) and McNeilly would naturally be disinclined to overrule or distinguish their own work. The institutional aesthetics of the Delaware Supreme Court suggest another reason why the two Justices might not deal more directly with *Pogostin*. The Delaware Supreme Court places an extraordinarily high value on continuity and unanimity. The supreme court normally hears cases in rotating panels of three of its five Justices.[86] No panel of Justices may overrule a precedent.[87] Further, no Justice may dissent from a panel's decision.[88] If the panel desires to reconsider a precedent or if a Justice on a panel is inclined to dissent, the case is considered *en banc*.[89] In the five years before *Unocal* was decided, only eleven percent of the supreme court's corporate law decisions were even heard *en banc* and over ninety-six percent were unanimous.[90] This ethos of unity might have been a strong reason not to upset recently established case law.

The distastefulness of disunity might have been another reason why the supreme court chose not to address the *Pogostin* problem directly.

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[85]Justice Christie was the third Justice in *Pogostin*. Judge Taylor of the Delaware Superior Court was the third *Unocal* Justice, under a Constitutional requirement that a vacancy in a panel be filled by a judge from another state court. DEL. CONST. art. IV, § 12.

[86]DEL. SUP. CT. R. 3(c), 4(c); DEL. SUP. CT. IOP R. VI(2).

[87]DEL. SUP. CT. IOP R. VII.

[88]DEL. SUP. CT. R. 4(d).

[89]DEL. SUP. CT. R. 4(d); DEL. SUP. CT. IOP R. VII.

[90]Only Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985), and Lynch v. Vickers Energy Corp., 429 A.2d 497 (Del. 1981), involved dissents. These cases constituted 3.77% of the 53 corporate law decisions handed down by the Delaware Supreme Court between January 1, 1980 and May 17, 1985 (the day *Unocal* was orally decided). Six of those 53 cases (11.3%) were heard *en banc*. Search of LEXIS Corp Library, Highct File. In the noncorporate area during this period the supreme court was even more unanimous. The supreme court decided 788 noncorporate cases of which 98.86% (779) were unanimous. Only 5.33% (42) of the 788 noncorporate cases were heard *en banc*. During this period the supreme court decided 841 cases in all areas (including corporate law) of which 98.7% (830) were unanimous. Forty-eight of the 841 cases (5.71%) were heard *en banc*. Search of LEXIS States Library, Highct File.

The unity of the supreme court had been recently riven by *Van Gorkom*.[91] The court's *en banc* decision was three to two and included a vitriolic dissent by Justice McNeilly.[92] The case, which was decided less than four months before *Unocal*, must have been in the Justices' thoughts.[93] While it is impossible to know exactly how acrimonious the process of deciding *Van Gorkom* was, it is likely that Justice McNeilly or Justice Moore might have been less inclined to do battle with his colleagues so soon after *Van Gorkom*.

If my view is correct, the upshot of *Unocal* is that the court really intended the entire fairness standard to apply to takeover settings but recognized, as it did in *Cheff*, that the directors may have an easier time meeting their burden when they do not have a direct pecuniary interest in the challenged transaction. This view is consistent with both the *Unocal* oral decision and Justice Moore's written *Unocal* decision. When it ruled orally, the panel took the view that its hands were tied by *Pogostin*. But, by the time the written opinion was finished, the panel, and perhaps the entire supreme court, was prepared to move by degrees away from *Pogostin*.

Thus, Justice Moore married two peacefully coexisting doctrines and created *Unocal*. As with many marriages, there seems to have been no impelling logic or necessity. And, as with many marriages, the responsible parties spent a great deal of time in the early years explaining and justifying to their friends why this happened. For the first two and a half years after *Unocal*, Justices Moore and McNeilly tried to explicate *Unocal* to their colleagues and to the Court of Chancery judges. We hear, for the first time, from the principal interlocutor in *Unocal*'s life, Chancellor William T. Allen, who by responding to the Delaware Supreme Court, made *Unocal* come alive. It was he who began the conversation about *Unocal* by the way in which he conceived of the cases brought before him and the way in which he used the supreme court's assertions about *Unocal*.

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[91]Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

[92]*Id.* at 893. Justice Christie also dissented in a strong but moderated opinion. *Id.* at 898.

[93]*Van Gorkom* was decided on January 29, 1985 and *Unocal* was decided orally on May 17. *Van Gorkom*, 488 A.2d at 858; *Unocal* Oral Decision, [1984-1985 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,046, at 91,211.

III.

A. *Take a Pill and Sue Me in the Morning*

The first thing Justice McNeilly did was reinforce the notion that *Unocal* is not identical with the business judgment rule but is nonetheless rooted there. He also expanded *Unocal*'s reach beyond takeover cases to any board action that could be used in a defensive posture, even if no takeover bid were perceived. Remarkably, the vehicle in which Justice McNeilly did this, *Moran v. Household International, Inc.* (*Moran II*),[94] was one in which his *Unocal* explanation was not central to the decision. It simply was engrafted to another, more traditional analysis.

Four days after the written opinion in *Unocal* was released a supreme court panel of Chief Justice Christie, Justice McNeilly, and Justice Moore heard argument in *Moran II*, which involved the first challenge to a board's adoption of a poison pill.[95] Justice McNeilly characterized the board's adoption of the pill as a prophylactic measure rather than one in response to a specific takeover threat.[96] That, said Justice McNeilly, made the business judgment rule particularly appropriate.[97] Although he could have used that distinction to remove the case from *Unocal*, Justice McNeilly chose instead to hold that *Unocal* applies to the adoption of any defensive mechanism, even if a corporation were not faced with an imminent takeover.[98]

But the bulk of Justice McNeilly's discussion in *Moran II* was whether the Delaware statute even permitted the poison pill.[99] I think two possible explanations, not exclusive of one another, are likely for why *Unocal* gets short shrift. First, *Unocal* came down only four days before the *Moran II* oral argument. Counsel would not have had much time to incorporate *Unocal* into their case. Second, the latest case holding

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[94]500 A.2d 1346 (Del. 1985).

[95]*Id.*

[96]The Court of Chancery opinion, by Vice-Chancellor Walsh, made it very clear that the plaintiff, an outside board member who was chief executive officer of Household International's largest shareholder, was attempting to negotiate a friendly acquisition of Household International. Moran v. Household Int'l, Inc., 490 A.2d 1059, 1064-5 (Del. Ch. 1985) [*Moran I*], *aff'd*, 500 A.2d 1346 (Del. 1985).

[97]*Moran II*, 500 A.2d at 1356.

[98]*Id.*

[99]*Id.* at 1351-55. Justice McNeilly spent one page (1350) deciding that the business judgment rule applied, per *Unocal*, and nearly five pages deciding that the Delaware General Corporation Law in fact authorized a board to adopt a poison pill (1351-1355), and less than a page and a half applying *Unocal* (1355-1357).

directors liable, *Van Gorkom*,[100] not quite four months old, was decided on precisely the same day Vice-Chancellor Walsh issued his *Moran I* opinion. *Van Gorkom* suggested that an attack based on the directors' duty of care might well be successful in the takeover setting.[101] Combined both with *Unocal*'s holding that the business judgment rule applied to duty of loyalty takeover cases and with *Unocal*'s outcome, holding the directors' action permissible, rational counsel might well decide to pursue a care claim rather than a loyalty claim. Strong, though indirect, evidence for this theory comes from the Court of Chancery's opinion in *Moran I*, in which the plaintiffs clearly asserted a duty of loyalty claim in addition to a duty of care and statutory authority claims.[102] Just as clearly, plaintiffs abandoned their loyalty claim in the supreme court.[103]

So, although Justice McNeilly ostensibly staked out additional territory for *Unocal*, and ostensibly made clear that *Unocal* is based on, though distinct from, the business judgment rule (and distinct from intrinsic fairness, for that matter), internally the case does something very different. Once the directors' loyalty is conceded, which on the facts of this case it need not have been, then only two issues can remain: whether the board's action was permitted under the statute and whether the directors were adequately informed. Neither implicates *Unocal*. *Moran II*, then, becomes only rhetoric and a guide to how the Delaware Supreme Court wanted *Unocal* to be perceived, but not a reliable guide to what the Delaware Supreme Court actually thought *Unocal* does.

B. *On the Other Hand, Not So Fast*

The first genuine application of *Unocal* came from Justice Moore nine months later in *Revlon, Inc. v. MacAndrews & Forbes Holdings*.[104]

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[100]Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

[101]*Id.* at 873.

[102]*See Moran I*, 490 A.2d at 1070-71.

[103]See *Moran I*, 490 A.2d at 1070-71, 1075-76; *Moran II*, 500 A.2d at 1356.

[104]506 A.2d 173 (Del. 1986). Pantry Pride made an unwanted all cash bid for any and all shares. *Id.* at 177. After a considerable amount of scrambling around, the Revlon management adopted a poison pill and undertook a self tender for about one-third of its stock in exchange for Notes which not only required the company to pay heavy interest, but contained covenants restricting the company from taking on additional debt in many instances. *Id.*

Later, Revlon struck a deal with Forstmann Little & Company. *Id.* at 178. As finally negotiated, Forstmann would tender for Revlon stock at a price that was equivalent to or perhaps a tad better than the price Pantry Pride was offering. *Id.* at 178 & n.6. In what became the central, controversial term of the deal, Forstmann also agreed to support the market

Again, Justices Moore and McNeilly constituted two-thirds of the panel deciding the case. As in *Unocal* itself, they were joined by a judge from the Delaware Superior Court, Judge Balick.[105] As in *Moran II*, the *Unocal* rhetoric and the *Unocal* application are two different things.

Justice Moore's written decision could be interpreted in three ways. Most mechanically, it could be an affirmation that *Unocal* is simply a special case of the business judgment rule for takeovers. Support for this view would be found in the fact that Justice Moore affirmed Justice Walsh's rulings in the Court of Chancery.[106]

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value of the notes, which had fallen because the covenants had been waived by Revlon in the course of the takeover battle. *Id.* at 178-79. The noteholders were upset by the fall in value and the board anticipated litigation unless the market price of the Notes could be reinforced. *Id.* at 182.

In return for supporting the notes, Forstmann obtained three concessions which also served to make Pantry Pride's offer untenable. *Id.* at 178. First, Forstmann was given an option to purchase certain desirable Revlon assets at a significant discount should another entity acquire 40% or more of Revlon's stock (the "lock-up"). *Id.* Second, Revlon was prohibited from sharing proprietary information with any other entity (the "no shop"). *Id.* Finally, Forstmann would get a $25 million cancellation fee if another entity acquired more than 19.9% of Revlon's stock or if for any reason the Forstmann-Revlon agreement were terminated (the "cancellation fee"). *Id.* Pantry Pride sought an injunction barring these agreements. *Id.* at 179.

[105] *Id.* at 175. In its oral decision, without citing *Unocal* by name, the court simply affirmed Justice Walsh's conclusion that the transactions were not subject to the protections of the business judgment rule. *Revlon* Oral Decision, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,357 (Del. Nov. 1, 1985).

[106] Justice Walsh, sitting in the Court of Chancery, found that the lock-up and no shop provisions were improper. MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc., 501 A.2d 1239, 1250-51 (Del. Ch. 1985), *aff'd*, 506 A.2d 173 (Del. 1986). Justice Walsh was assigned to resolve this case at the Court of Chancery level because he had been a Vice-Chancellor and presumably had been the judge to whom the case was initially assigned. *See* DEL. CONST. art. IV, § 13(2). He treated *Unocal* as simply an elaboration of a particularized application of the business judgment rule. In effect, he saw *Unocal*'s caveats as integral parts of the business judgment rule analysis in takeovers, rather than as a two-step predicate to the rule.

> Of necessity, the starting point for an analysis of Revlon's conduct must be the application of the business judgment rule. As a result of recent decisions of the Delaware Supreme Court which applied the business judgment rule in the context of responses to acquisition attempts, certain standards of director conduct have evolved. . . . But even an informed board may not exercise unbridled discretion. An element of balance is required to insure that the measure adopted is reasonably designed to meet the posed threat. *Unocal*, 493 A.2d at 955. This balance overlay must be applied to the particular circumstances of each situation, in order to gauge the reasonableness of the response against the perceived threat.
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> . . . .
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> [The Forstmann agreement], however, was the result of the prior takeover responses made by the Revlon board which must be separately tested under the business judgment rule.

More subtly, Justice Moore can be read as reinforcing the idea that *Unocal* is a predicate for the business judgment rule and has its roots there. In other words, *Unocal* is truly an intermediate test, closer to the business judgment rule than to intrinsic fairness. The interesting part of *Revlon*, in this view, is that Justice Moore announced that the actions directors may choose consistent with their fiduciary duties are limited considerably when the inevitable break up of the company is apparent to all. In that setting, they meet their fiduciary duties only by maximizing the current value of the company.[107] This is the usual interpretation of *Revlon*.

A closer reading, though, reveals a third interpretation, one with a distinct intrinsic fairness strand. The actual holding of the case is that, after the company put itself up for sale, the directors breached their duties because their actions were not designed to, and did not, get the best price for the shareholders. Justice Moore's language analyzing *Unocal* in relation to the poison pill and the exchange offer was simply dictum.[108]

. . . .

> [I]n general terms [the poison pill's] adoption falls within the business judgment rule as a prospective device calculated to strengthen the board's bargaining position.

Revlon, 501 A.2d at 1247.

The poison pill and exchange offer were permissible under Justice Walsh's analysis, *id.* at 1247-48, but the lock-up and no shop provisions were not. *Id.* at 1250. In invalidating the lock-up and no shop, Justice Walsh used *Unocal*'s proportionality requirement as a measure for whether the directors' actions met their duty of loyalty. He did not use *Unocal* as a screen to determine whether the business judgment rule would apply.

> By agreeing to a lock-up and no shop clause in exchange for protecting the rights of the Noteholders, the Revlon Board failed in its fiduciary duty to the shareholders. The board may have been informed, but its performance did not conform to the other component of the business judgment rule — the duty of loyalty. . . . Thus, the element of loyalty may turn, as it does here, in the selection of a takeover defense or a bargaining device that is not proportionate to the objective needs of the shareholders but merely serves the convenience of the directors. *Unocal*, 493 A.2d at 955.

. . . .

> Where . . . there is only one genuine bidder in the picture and there is a risk of losing his participation in a fast-moving situation, the quick action of directors in granting an option on substantial corporate assets will not be second-guessed under the business judgment rule. . . . [On facts such as these], a different result follows. The business judgment rule does not protect such action. Having assumed the role of primary negotiator through the restriction on the alienability of shares, the directors must demonstrate the rationality of their decisions.

Id. at 1250.

[107] *Revlon*, 506 A.2d at 182.

[108] *Id.* at 180-85.

While at one point Justice Moore's words hint that *Unocal* is being used,[109] his description of how the board went wrong strongly suggests that he is requiring the board to demonstrate that its actions were fair to the shareholders:

> [T]he Revlon board could not make the requisite showing of good faith by preferring the noteholders and ignoring its duty of loyalty to the shareholders. . . . [W]hen the Revlon board entered into an auction-ending lock-up agreement with Forstmann on the basis of impermissible considerations at the expense of the shareholders, the directors breached their primary duty of loyalty. . . . [U]nder all the circumstances the directors allowed considerations other than the maximization of shareholder profit to affect their judgment, and followed a course that ended the auction for Revlon, absent court intervention, to the ultimate detriment of its shareholders.[110]

After *Revlon*, Justice Moore seems to be saying that, when the corporation has put itself up for sale, the directors must get the best price for the company and that their actions will be subject to intrinsic fairness to ensure that such a price was realized.

C. *Go With the Spirit*

The most academic of the Delaware judges, Chancellor William T. Allen, first considered the *Unocal* problem, a little over a year after *Unocal* was decided, in *AC Acquisitions Corp. v. Anderson, Clayton & Co.*[111] Chancellor Allen ostensibly took the Delaware Supreme Court at

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[109] *Id.* at 183 ("Under such circumstances we must conclude that the merger agreement with Forstmann was unreasonable in relation to the threat posed."). If Justice Moore were really following *Unocal*'s words, he would have said that the court must conclude that the board has not shown that its action was reasonable. That he finds, instead, that the actions were unreasonable suggests that he is going straight to an analysis of the action itself rather than a consideration of the board's characterization.

[110] *Id.* at 182, 185.

[111] 519 A.2d 103 (Del. Ch. 1986). The Anderson Clayton board, in response to a hostile tender offer, approved a coercive partial self-tender with an imputed value roughly comparable to that offered by the bidder. *Id.* at 104. The bidder offered $56 in cash per share for 51% of the stock and announced its intention to consummate a cash out merger also at $56 per share in cash. *Id.* The target's response was to tender for 65.5% of its shares for $60 per share in cash, leaving the remaining 34.5% of the shares worth about $13 — $18 per share. *Id.* at 108 n.6. The target's response was coercive because shareholders who did not tender to

its word and assumed that *Unocal* meant to establish an intermediate standard of review.[112] He speculated that *Unocal*'s reason for establishing this third standard was because the choice of standard is often determinative of the outcome.[113]

Having done so, Chancellor Allen then faced the tasks of applying *Unocal*'s test and differentiating it from the business judgment rule and entire fairness. He found that, while the board reasonably perceived a threat from the bidder, its reaction was not reasonable in relation to the threat.[114] The board's alternative plan was unreasonable because it coerced shareholders into accepting it rather than simply providing an alternative offer to the bidder's threat.[115]

Despite a game effort, Chancellor Allen was unable to differentiate the *Unocal* test from entire fairness. Throughout his analysis he analogized the *Unocal* inquiries to those under entire fairness.[116] For example, Chancellor Allen described the first part of *Unocal* as being, on those facts, simply a particularized application of the rule from *Bennett* that a stock repurchase must serve a corporate rather than personal purpose.[117] More centrally, Chancellor Allen came to grips with the issue when he asked, "What then is the legal consequence of a conclusion that [a board's action] is not reasonable in relation to the threat posed?"[118] Clearly, he said, the business judgment rule is inapplicable and normally in such circumstances a board's action "can only be sustained if it is objectively or intrinsically fair; an honest belief that the transaction was entirely fair will not alone be sufficient. Similarly here, . . . all aspects of the transaction must be deemed fair to the shareholders (regardless of subjective intent) . . . ."[119]

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the target company (including those who tendered to the bidder) risked having all their shares valued at $13 — $18 if the self-tender were successful. *Id.* at 108, 113. So, rational shareholders would tender to the target company even if they did not believe it offered the better alternative than the bidder. *Id.* at 113.

[112] *Id.* at 111.

[113] *Id.*

[114] *Id.* at 113.

[115] *AC Acquisitions*, 519 A.2d at 112-13.

[116] *Id.* at 112-15.

[117] *Id.* at 112.

[118] *Id.* at 114.

[119] *AC Acquisitions*, 519 A.2d at 115.

D. *The Oldest Established Permanent Floating Standard in the Law*

If Chancellor Allen were selling the proposition that *Unocal* was full of rather loose language that really meant entire fairness, Justice Moore was not buying.[120] Three months after *AC Acquisitions*, Justice Moore reiterated in *Ivanhoe Partners v. Newmont Mining Corp.* that *Unocal* genuinely was a third standard of review neither the business judgment rule nor entire fairness.[121] He did leave a door open that Chancellor Allen quickly realized could present the solution to the alternative of a world in which *Unocal*, as something other than intrinsic fairness, would rule the day.

This time Justice Moore wrote with Chief Justice Christie and Judge Bifferato from the Delaware Superior Court. Functionally, Justice Moore declined to apply intrinsic fairness and instead used business judgment.[122] Formally, he held that *Unocal*'s test, which he reiterated is an intermediate test, had been met and that the *Revlon* duties did not attach.[123]

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[120]*See* Ivanhoe Partners v. Newmont Mining Corp. (*In re* Newmont Mining Corp. Shareholders Litig.), 535 A.2d 1334 (Del. 1987).

[121]*Id.* In *Ivanhoe*, the target, Newmont Mining, had entered into a standstill agreement to end a takeover attempt by Consolidated Gold Fields PLC. *Id.* at 1338. Gold Fields, which owned 26% of Newmont's stock, would buy no more than one-third of the stock, would have no more than three of the nine board slots (in the event, Gold Fields controlled only two slots), would support management's positions, and would give Newmont a right of first refusal in any sale of Gold Fields' stake. *Id.* The standstill agreement was terminable at Gold Fields' option if any other entity owned more than 9.9% of Newmont's shares. *Id.*

Four years after the standstill was signed, Ivanhoe Partners, run by Boone Pickens of Mesa fame, bought 9.95% of Newmont and announced a cash tender offer for 42% of Newmont. *Id.* at 1338-39. While Ivanhoe stated that it intended to acquire all nontendered shares at the same price and in cash, it distinctly refrained from committing itself to such a second step, leaving the possibility that nontendering shareholders would be frozen into their minority position. *Id.* at 1339. Pickens hoped Gold Fields would join with Ivanhoe in its takeover of Newmont but instead Gold Fields cut a better deal with Newmont. *Id.* at 1338-40. Newmont declared a $33 per share dividend providing cash to Gold Fields which allowed it to street sweep 23.7% of Newmont over the course of two days, giving it 49.7%. *Id.* at 1340. The dividend was intended to dry up Newmont's liquidity and represented the value of Newmont's noncore businesses which were to be sold quickly. *Id.* at 1339-40. The dividend was to be financed by the sale of Newmont's nonmining assets. *Id.* at 1339. In return, Gold Fields was limited to owning no more than 49.9% of Newmont, continued to be prohibited from opposing management or selling to other parties, and could nominate no more than 40% of the Newmont board positions. *Id.* at 1340.

[122]*Id.* at 1341.

[123]*Id.* at 1345.

Unocal was by now "well established" said Justice Moore.[124] He serenely found both that Ivanhoe and Gold Fields posed threats and that Newmont's response was reasonable in relation to those threats.[125] Ivanhoe's bid was both inadequate and coercive and Gold Fields had the power and perhaps the inclination to take over Newmont.[126] Turning to the reasonableness of Newmont's response, Justice Moore found that the Newmont board was entitled to some deference because Gold Fields' representatives on the board absented themselves during the deliberations.[127]

Revlon duties did not devolve on the board because Newmont had neither been sold nor had put itself up for sale, and because no contest for control among more than one bidder had developed.[128] Of course, neither of these conclusions were ineluctable. Justice Moore could have regarded the revised standstill agreement and proposed asset sale as a breakup, a sale, or both. Newmont was to radically restructure itself by focusing its operations on its core business and transferring the value of its noncore assets to the shareholders, and Gold Fields was to increase its stake to 49.7%.[129] Vice-Chancellor Jacobs specifically found that Gold Fields, when considered together with management's small share ownership, had majority control of Newmont.[130] Likewise, the Newmont board's decision to negotiate and consummate the revised standstill could have been characterized as a decision "apparent to all" to put Newmont up for sale just as in *Revlon*.[131]

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[124]*Ivanhoe*, 535 A.2d at 1341.

[125]*Id.* at 1342-44.

[126]*Id.* at 1342.

[127]*Id.* at 1343. He then considered the dividend, standstill revision, and street sweep together because they were part of a unified response. *Id.* Together, these actions served to prevent exactly the harms Ivanhoe posed. The dividend was responsive to the threat of inadequate price because it moved the full value of the noncore assets into the shareholders' hands. *Id.* It also provided Gold Fields with the incentive to sweep the street. *Id.* The standstill and street sweep neutralized the coercive aspect of Ivanhoe's offer and the threat that Gold Fields would take control. *Id.* at 1343-44. Because of the standstill revision and street sweep, Newmont remained independent and became in effect invulnerable to an unwanted takeover. *See id.*

[128]*Ivanhoe*, 535 A.2d at 1345.

[129]*Id.* at 1339-40.

[130]Vice-Chancellor Jacobs had found that Newmont management owned .5% of its stock, giving Gold Fields "majority control." Ivanhoe Partners v. Newmont Mining Corp., 533 A.2d 585, 598 (Del. Ch.), *aff'd*, 535 A.2d 1334 (Del. 1987).

[131]Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) ("[W]hen Pantry Pride increased its offer to $50 per share, and then to $53, it became apparent to all that the break-up of the company was inevitable.").

Justice Moore's finding that no contest for control had developed might also have been decided the other way. Surely one could have seen Gold Fields as a potential bidder for Newmont who turned into an ally, precisely as Revlon had searched out and allied itself with Forstmann Little. Further, Justice Moore himself seemed a tad confused about whether intrinsic fairness applied. Although he wrote that "we do not start with an intrinsic fairness analysis," the *Unocal* omnipresent specter "plac[es] upon the directors the burden of proving that they have not acted solely or primarily out of a desire to perpetuate themselves in office" in addition to the *Unocal* requirements of showing a threat and showing that the response was proportionate.[132] Although Justice Moore did not cite *Cheff*, that case, with its intrinsic fairness burden, was surely the allusion.

IV.

In the first two and a half years of *Unocal*'s life, the Delaware Supreme Court spoke about it three times, twice by Justice Moore.[133] For the next year and a half, the Delaware Supreme Court was silent. It was finally the Court of Chancery's turn to make sense of *Unocal*, develop its contours, and decipher Justice Moore's intentions. Chancellor Allen began to dismember *Unocal* almost immediately. He carved out several areas in which he held *Unocal* was inapplicable. When he did apply *Unocal*, Chancellor Allen interpreted both aspects, but particularly the proportionality requirement, to function much like the intrinsic fairness test. Likewise, in four other influential Court of Chancery opinions three other judges treated *Unocal* as being virtually equivalent in its application to the intrinsic fairness test. Only one member of the Court of Chancery, Vice-Chancellor Berger, treated *Unocal* differently. She did not, though, treat *Unocal* as a third test. Rather, she saw *Unocal* as at bottom the business judgment rule.[134] Her rulings would have brought the vast majority of takeover fights under *Unocal* and given management's actions enormous deference.

The first thing Chancellor Allen did was to carve away the *Revlon* setting from *Unocal*. He did this in a pair of cases, *Solash v. Telex*

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[132]*Ivanhoe*, 535 A.2d at 1341.

[133]*Ivanhoe*, 535 A.2d 1334 (Del. 1987); *Revlon*, 506 A.2d 173 (Del. 1986); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985).

[134]Shamrock Holdings, Inc. v. Polaroid Corp. (*In re* Polaroid Shareholders Litig.), 559 A.2d 257, 269 (Del. Ch. 1989) [*Polaroid I*] (stating that "[t]he business judgment rule is available to directors even where they are responding to a takeover threat").

Corp.[135] and *In re J.P. Stevens & Co. Shareholders Litigation.*[136] Both involved a sale of the target corporation to a white knight in the face of a hostile bid from a raider.[137] In *Solash* Chancellor Allen ignored *Revlon* and applied the business judgment rule.[138] In *J.P. Stevens* he recognized that *Revlon* was pivotal and judged compliance with those duties under the business judgment rule.[139] In neither instance did he suggest that *Unocal* would even arguably be appropriate as either a predicate for the business judgment rule or a substitute for the business judgment rule or intrinsic fairness.

A. *White Christmas*

Ivanhoe was decided just before Thanksgiving. Over the holidays, Telex Corporation staved off a raider by finding Memorex, a white knight, in its Christmas stocking.[140] The Telex board also briefly considered a recapitalization plan, but abandoned it when the Memorex deal came to fruition.[141]

On the face of it, Telex's reaction to the raider looks like *Revlon* and *Unocal*. Although the sale of Telex was not perhaps "inevitable" as in *Revlon*, it certainly was the board's preferred option, just as it was to the Revlon board. In any event, the board's decision to enter into the

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[135]Solash v. Telex Corp., [1987-88 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608 (Del. Ch. Jan. 19, 1988), *reprinted in* 13 DEL. J. CORP. L. 1250 (1988).

[136]West Point-Pepperell, Inc. v. J.P. Stevens & Co. (*In re* J.P. Stevens & Co. Shareholders' Litig.), 542 A.2d 770 (Del. Ch.), *appeal refused*, 540 A.2d 1088 (Del. 1988).

[137]*Solash*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608, *reprinted in* 13 DEL. J. CORP. L. at 1254; *J.P. Stevens*, 542 A.2d at 778.

[138]*Solash*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608, *reprinted in* 13 DEL. J. CORP. L. at 1254.

[139]*J.P. Stevens*, 542 A.2d at 778.

[140]*Solash*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608, *reprinted in* 13 DEL. J. CORP. L. at 1259.

[141]*Id.* at 97,725-26, *reprinted in* 13 DEL. J. CORP. L. at 1261. Even though the raider had been paid off and withdrawn its offer leaving the Memorex transaction as the only proposed extraordinary transaction, Telex shareholders sued to enjoin the Memorex deal on the ground that it offered less value than the recapitalization. *Id.* at 97,723, 97,726, *reprinted in* 13 DEL. J. CORP. L. at 1258, 1261. Plaintiffs also included a claim of incomplete disclosure in violation of Delaware law. *Id.* at 97,729-30, *reprinted in* 13 DEL. J. CORP. L. at 1267-68. Plaintiffs offered two explanations for the Telex board's preference for Memorex. First, Telex's investment banker, Drexel Burnham Lambert, Inc., owned 10% of Memorex and so stood to benefit proportionally from any Telex value Memorex gained. *Id.* at 97,725, *reprinted in* 13 DEL. J. CORP. L. at 1261. Second, the Memorex deal included stock incentives for senior Telex officers and employees including the three inside directors (out of a board of ten). *Id.* at 97,726, *reprinted in* 13 DEL. J. CORP. L. at 1261. Telex management was to make the allocation among the eligible recipients. *Id.*

Memorex deal surely was in response to the raider's bid and so *Unocal* must apply. Chancellor Allen did not explicitly speak to *Revlon* at all.[142] Chancellor Allen also did not find *Unocal* applicable because he viewed the trigger to be whether plaintiff can show the directors had a conflict of interest.[143] Only three of the ten Telex directors were eligible to receive Memorex stock and continue in their positions after the transaction.[144] This was not enough, presumably, to create the kind of conflict *Unocal* was meant for.[145] So Chancellor Allen fell back on the business judgment rule and found that neither the stock plan nor reliance on Drexel was grossly negligent.[146]

B. *A January White Sale Run Amok*

Chancellor Allen quickly followed up *Solash* with *J.P. Stevens*, in which he brought *Revlon* and intrinsic fairness back into his analysis.[147]

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[142]In *J.P. Stevens*, Chancellor Allen revealed that he viewed *Revlon* as applying only when the directors faced a conflict of interest. *J.P. Stevens*, 542 A.2d at 781.

[143]*Solash*, [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,608, at 97,727, *reprinted in* 13 DEL. J. CORP. L. at 1262.

[144]*Id.* at 97,724, *reprinted in* 13 DEL. J. CORP. L. at 1260.

[145]*See id.* at 97,728 & n.3, *reprinted in* 13 DEL. J. CORP. L. at 1263 & n.3.

[146]*Id.* at 97,728-29, *reprinted in* 13 DEL. J. CORP. L. at 1265-66.

[147]In January 1988, the senior managers of J.P. Stevens, the large textile manufacturer, decided to effect a management buyout. *J.P. Stevens*, 542 A.2d at 773. The board named all the outside directors to a special committee which announced both the management bid and that the committee would consider other proposals. *Id.* Within three weeks two other bidders appeared, West Point, a competitor of J.P. Stevens, and Odyssey Partners, apparently an investment vehicle. *Id.* Over the next few weeks the special committee conducted several rounds of bidding. *Id.* at 773-76. During the course of this contest, the management group dropped out and at the end, the special committee struck a deal with Odyssey Partners. *Id.*

Even though West Point offered $62.50 per share, slightly more than Odyssey Partner's $61.50 bid, the special committee preferred Odyssey Partners because a combination with West Point posed antitrust concerns that, even if surmountable, would involve delay. *Id.* at 774. The Odyssey Partners deal, by contrast, was both more likely to be completed and to be completed more quickly. *Id.* at 776. In response to J.P. Stevens' agreement with Odyssey Partners, West Point found an equity partner and announced its willingness to pay $64.00 per share in a friendly transaction. *Id.* Odyssey Partners and J.P. Stevens then renegotiated their deal to provide for a price of $64.00. *Id.* at 772, 776-77, 779.

West Point challenged two aspects of the contest, claiming that they violated *Revlon* duties. First, Odyssey Partners got nonpublic information about J.P. Stevens early in the bidding while West Point got the same information rather late. *Id.* at 777. Odyssey Partners got the information earlier because it signed a confidentiality and standstill agreement while West Point balked until near the end of the bidding. *Id.* at 777-78. Second, the Odyssey Partners deal, as finally negotiated, provided a topping fee and expense reimbursement should the deal not go through, which West Point claimed impeded the auction process. *Id.* The special committee preferred Odyssey Partners because, claimed West Point, Odyssey Partners

Chancellor Allen made *Unocal* irrelevant by bringing in *Revlon* and a clever interpretation of intrinsic fairness. According to Chancellor Allen, *Revlon* applies when a change of control takes place and limits the board to attempting to secure the highest value for the shareholders.[148] It does not, said Chancellor Allen, render any transaction or provision per se impermissible.[149] Triggering of *Revlon* duties does not, by itself, entail any particular standard of review by the court.[150] Rather, the court looks at the traditional tests for whether the business judgment rule, intrinsic fairness, or *Unocal* applies.[151]

While Chancellor Allen thought West Point's scenario about the special committee's motivation plausible, he found it insufficiently convincing to trigger intrinsic fairness.[152] In the same breath he said *Unocal* did not apply because the special committee's actions were not "designed to defeat a threatened change in control," citing *Unocal* and *Ivanhoe*.[153] Rejecting any power to review the substance of the special committee's decisions under *Unocal* or the business judgment rule, Chancellor Allen proceeded to do just that.[154]

The business judgment rule has always contained what Chancellor Allen called an "escape hatch" which permitted, or perhaps required, a court to examine the substance of a board decision to see whether it was so far beyond what a reasonable board would do that the action was proof of the board's bad faith.[155] But the opinions seldom did more than mention this theoretical possibility. In practice, the courts ordinarily undertook only the most cursory review (if they even went that far) of a board's decision. Nonetheless, under the guise of the business judgment rule in which the burden was nominally on the plaintiffs, Chancellor Allen proceeded to review the substance of the special committee's actions and found them appropriate.[156]

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anticipated retaining current J.P. Stevens management and would even give them equity. *Id.* at 779.

[148] *Id.* at 779.

[149] *Id.* at 782.

[150] *See id.* at 780-81.

[151] *See J.P. Stevens*, 542 A.2d at 780-82.

[152] *Id.* at 779-80.

[153] *Id.* at 780 ("I note preliminarily that, as currently viewed, this case involves neither a self-dealing transaction . . . nor corporate measures designed to defeat a threatened change in control, *see Unocal* . . . *[Ivanhoe]*.").

[154] *Id.* ("Thus, I do not regard myself as authorized by *Unocal* or any other precedent of this court or the Supreme Court to pass upon the reasonableness of the . . . [special committee's actions], except in one respect.").

[155] *J.P. Stevens*, 542 A.2d at 780-81.

[156] *Id.* at 781-85.

C. *Bass-O-Matic*

Unlike Chancellor Allen, Vice-Chancellor Jacobs, in *Robert M. Bass Group, Inc. v. Evans*,[157] accepted wholeheartedly the concept that *Unocal* is genuinely different from the other standards.[158] Like *AC Acquisitions*, *Robert M. Bass Group* involved a management restructuring in the face of an unwanted tender offer.[159]

Vice-Chancellor Jacobs began his analysis by parsing the reviewing standards into three: business judgment, entire fairness, and *Unocal*.[160] The interesting portion of the opinion comes when he discusses whether the board's response was reasonable in relation to the threat posed. Unlike Chancellor Allen in *AC Acquisitions*, Vice-Chancellor Jacobs's language does not equate *Unocal* with entire fairness.[161] Nonetheless, it is hard to see his decision turning on anything but an evaluation of the restructuring's fairness. Epitomizing, the Vice-Chancellor held that a reasonable response under *Unocal* would require the board to offer a higher alternative or a chance for the shareholders to choose between the bids.[162] Restated, the management proposal was enjoined because it was both coercive and economically inferior.[163]

To me, this is the same as finding that the management response is invalid because it is not scrupulously fair to the shareholders. As if this discussion were not enough, the Vice-Chancellor continued with considerations that are nothing if not rooted in the entire fairness standard. Under the rubric, "Other Unreasonable Aspects of the Restructuring,"[164] Vice-Chancellor Jacobs noted two aspects of the restructuring that he found unreasonable under *Unocal* even though "from a strictly legal standpoint, no further analysis under *Unocal* [was]

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[157]552 A.2d 1227 (Del. Ch. 1988).

[158]*Id.*

[159]Vice-Chancellor Jacobs found that the tender offer, though fair, might constitute a threat in that it arguably was not the highest price obtainable in a sale of the company. *Id.* at 1241. Vice-Chancellor Jacobs found that the target board's alternative plan was impermissible because it was unreasonable in relation to the threat posed. *Id.* at 1241. Management's response was to develop a restructuring in which the company was to be split into two corporations and spun off to the current shareholders in such a way that incumbent management would remain in control of the more valuable of the two. Because management's restructuring could be accomplished by board resolution, the shareholders would not be able to tender to the bidder unless the restructuring were enjoined. *Id.* at 1242.

[160]*Id.* at 1239.

[161]*See id.* at 1241.

[162]*Robert M. Bass Group*, 552 A.2d at 1241-42.

[163]*Id.* at 1242-44.

[164]*Id.* at 1244.

required."[165] First, the restructuring would make the more important spin off corporation "takeover proof."[166] Second, the board's valuation methods understated management's equity interest in the restructuring, which the Vice-Chancellor specifically found to be excessive and not reasonable to the company or its shareholders.[167]

The important point is that the Vice-Chancellor found these aspects to be additional reasons for granting an injunction but did not tie them to the raider's bid.[168] In other words, they were impermissible without considering their reasonableness *vis-à-vis* the raider's threat as *Unocal* would require. In short, they are further evidence that the restructuring was enjoined because the defendants could not show that it was entirely fair.

D. *A Greek Meets Some Geeks*

Meanwhile, Chancellor Allen continued to be resistant to reeducation. In *Blasius Industries, Inc. v. Atlas Corp.*,[169] Chancellor Allen feinted an application of *Unocal* by finding that the board reasonably perceived a threat and responded in good faith, tantamount to a finding that *Unocal* was met.[170] This setting seemed to fall squarely within the *Unocal* ambit described by the Delaware Supreme Court: a target board's adoption of a defensive mechanism.[171] But then the Chancellor held that a target board's adoption of a defensive mechanism *designed to interfere with a stockholder vote* is not covered by *Unocal*.[172] Voting is different from other corporate actions first because it legitimates director power.[173] Thus, courts should not leave that legitimation process

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[165] *Id.*

[166] *Robert M. Bass Group*, 552 A.2d at 1244-46.

[167] *Id.* at 1245.

[168] *See id.* at 1244-46.

[169] 564 A.2d 651 (Del. Ch. 1988). The bidder began a shareholder consent solicitation campaign to expand the seven member board to fifteen and fill the new slots with sympathetic directors. *Id.* at 653-54. In response, the target board held an emergency meeting, expanded the board by two and filled the new slots with directors sympathetic to the management. *Id.* at 652-54. As the intended result of the board's action, the bidder would be unable to fill a majority of the board by its consent solicitation. *Id.* at 655. The opinion is an amalgam of two actions. Chancellor Allen's discussion of the second suit includes a really cool description of the mechanics of proxy solicitations. *See id.* at 663-70.

[170] *Id.* at 658.

[171] Moran *II*, 500 A.2d 1346, 1356 (Del. 1985).

[172] *Blasius Indus., Inc.*, 564 A.2d at 659. The Chancellor found that the board's principal intention was to thwart the bidder's consent solicitation. *Id.* at 655.

[173] *Id.* at 659.

completely in the hands of the board itself.[174] A board action regarding voting is also different because it is not a business decision, so courts need not defer to the board's business acumen.[175]

One might think, then, that board infringement of shareholder franchise rights would always be impermissible, since those rights are so important. Well, it turns out that those rights can be impaired if the board shows a "compelling justification" for its action.[176] Here, the only justification was paternalistic: the board could prevent shareholders from acting because the board knows better than shareholders what course is best for the company.[177] That justification, said the Chancellor, is not enough: "The theory of our corporation law confers power upon directors as the agents of the shareholders; it does not create Platonic masters."[178]

E. *Is This a Dagger Which I See Before Me?*

Chancellor Allen's assault on the *Unocal* rule continued, about three months after *Blasius Industries, Inc.*, in *City Capital Associates Ltd. Partnership v. Interco Inc.*[179] For the first time he appeared to accept *Unocal* as a test separate from business judgment or entire fairness. In actual application, though, Chancellor Allen carved yet another area out of *Unocal*'s ambit and, where *Unocal* did apply, functionally decided the issues as ones of entire fairness.

The Chancellor seemed to embrace fully *Unocal*'s application on these facts. Chancellor Allen stated that the Delaware Supreme Court had specifically held that *Unocal* applies to the question of the redemption of a poison pill; further, although the board was interested, it was not the sort of interest that triggers entire fairness.[180] In fact,

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[174] *Id.*

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

[176] *Blasius Indus., Inc.*, 564 A.2d at 661.

[177] *Id.* at 663.

[178] *Id.*

[179] 551 A.2d 787 (Del. Ch.), *appeal dismissed*, 566 A.2d 1070 (Del. 1988). The bidder offered $74 per share in cash for any and all shares to be followed by a cash out merger also at $74 per share in cash. *Id.* at 789-90. The management responded with a restructuring, which it valued at $76, that would have involved the sale of significant assets, the assumption of over $2 billion in debt, and the declaration of a dividend consisting of debt, common stock, and $66 in cash. *Id.* at 790. Management prevented the bidder from completing its offer by not redeeming the target's poison pill. The bidder sued to enjoin the asset sale and dividend and to require the board to redeem the poison pill. *Id.* at 790-95.

[180] *Id.* at 790 & n.1 (citing Moran v. Household Int'l, Inc., 500 A.2d 1346, 1354 (Del. 1985); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1341 (Del. 1987)).

Chancellor Allen seemed almost glad to get another opportunity to use *Unocal*. It is "the most innovative and promising case in our recent corporation law. . . . The promise of that innovation is the promise of a more realistic, flexible and, ultimately, more responsible corporation law."[181]

To be sure, though, *Unocal* is no judges' plaything. In less than subtle hands, *Unocal* "could permit an unraveling of the well-made fabric of the business judgment rule."[182] So, a judge should apply *Unocal* "cautiously, with a clear appreciation for the risks and special responsibility this approach entails" to avoid *Unocal*'s danger, which is that courts "will too readily seek to assert the primacy of their own view on a question upon which reasonable, completely disinterested minds might differ."[183]

His paean to *Unocal* finished, Chancellor Allen set to work dismantling its impact in a variation of his *Blasius Industries, Inc.* approach. Schematizing the facts in this case, Chancellor Allen found that a "threat" for *Unocal* purposes had, until now, meant some type of shareholder coercion.[184] Here, though, the only threat to shareholders was from an inadequate price.[185] Could this be enough under *Unocal* for a board to respond? Chancellor Allen answered yes, but the only permissible response is for the board to arrange a transaction offering better value from the bidder, from a third party, or from a management restructuring.[186] If a board is undertaking this task it may keep the poison pill in place.[187] Once this task is finished, though, the only purpose of the poison pill is to preclude the shareholders from choosing between the alternatives — an impermissible response.[188]

Here, the values of the competing transactions were close enough that the board could not preclude shareholder choice.[189] Significantly, while Chancellor Allen clearly knew how to formulate *Unocal*'s

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[181]*City Capital Assocs.*, 551 A.2d at 796.

[182]*Id.*

[183]*Id.* at 796-97.

[184]*Id.* at 797 (citing the Delaware Supreme Court decisions in *Unocal*, *Moran II*, and *Ivanhoe*).

[185]*City Capital Assocs.*, 551 A.2d at 798. The target shareholders here were not coerced because the bidder was offering to buy any and all shares and the consideration would be the same in the follow up merger as it was in the initial tender offer.

[186]Maybe a board can "just say no," but maybe not. *Id.* at 798 n.13.

[187]*Id.* at 798.

[188]*Id.* Chancellor Allen, with a fine regard for the corporate bar's ingenuity, included language in his argument that allows for extraordinary circumstances that, in effect, he has not thought of yet.

[189]*City Capital Assocs.*, 551 A.2d at 799.

balancing test,[190] he stated his conclusion in objective rather than subjective terms: "I conclude that reasonable minds not affected by an inherent, entrenched interest in the matter, could not reasonably differ with respect to the conclusion that [City Capital Associates'] . . . offer did not represent a threat to shareholder interests sufficient in the circumstances to justify" keeping the poison pill in place.[191]

While this might mean only that the board's response was not reasonable in relation to the threat posed, it seems more consonant with the notion that the board had not demonstrated that its action in response to the bid was entirely fair. After all, how can it be unreasonable for management to effect a reasonable transaction? One of the Chancellor's specific findings of fact was that a reasonable shareholder might prefer either City Capital Associates' bid or management's response.[192] Where, then, is the deference to management that the business judgment rule and its *Unocal* predicate are based upon?[193]

The only real answer is that deference is absent because the board must show that its actions are objectively fair. In fact, this area may even be beyond entire fairness. Chancellor Allen's language borders on finding management's response in this setting (management precluding shareholders from choosing between alternative transactions) per se impermissible. If this is true, then Chancellor Allen moved beyond *Blasius Industries, Inc.*, finding a per se exclusion from *Unocal*.

If this interpretation is admittedly ambiguous when considering the poison pill issue, it becomes clearer when we examine Chancellor Allen's disposition of the asset sale issue. On the surface the Chancellor is comfortably in *Unocal* territory, finding that the sale does appear clearly to be reasonable in relation to the threat posed.[194] But, the conditions the Chancellor put on his characterization bring it to the very brink of entire fairness. Chancellor Allen made "some additional assumptions" — that the board was marketing the assets competently and that it would not sell

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[190] *Id.* at 796.

[191] *Id.* at 799.

[192] *City Capital Assocs.*, 551 A.2d at 796.

[193] Martin Lipton, the target company's counsel (and inventor of the poison pill), was furious at Chancellor Allen's opinion. Two days after it was issued, Mr. Lipton sent an open letter to the firm's clients which read, in part, "If [*City Capital Associates*] is not reversed by the Delaware Supreme Court, it will be a dagger aimed at the hearts of all Delaware corporations and a further fueling of the takeover frenzy." Letter from M. Lipton, partner in Wachtell Lipton Rosen & Katz, to Our Clients 1 (Nov. 3, 1988) (on file with author).

[194] *City Capital Assocs.*, 551 A.2d at 801 ("I therefore conclude that the proposed sale of Ethan Allen Company is a defensive step that is reasonable in relation to the mild threat posed . . . .").

the assets for less than a fair price or less than the highest price.[195] More embedded in the text are two further caveats: (1) *management had demonstrated* that the assets were not well integrated with the company's remaining assets, and (2) the sale would not preclude City Capital Associates' bid from being successful, though it may have required the bidder to reassess its offer.[196]

F. *Put Through the Mills*

The very next day, the Delaware Supreme Court heard argument and gave an oral decision in *Macmillan*.[197] Justice Moore managed to send a mixed message while making it clear that intrinsic fairness should have been applied. At one point he said, "Our decision in [*Revlon*] requires that there be the most scrupulous adherence to ordinary principles of fairness . . . ."[198] Two paragraphs later he said, "When senior management is a party to such breaches and, as here, has a personal interest in the outcome of the board's action, . . . [t]he business judgment rule has no application. Instead, the matter is governed by principles of intrinsic fairness."[199] This exactly focused on, and muddled, Chancellor Allen's discussion in *J.P. Stevens* about whether *Revlon* by itself requires certain actions or imposes a particular standard of review or whether it leaves management with a range of options to get to a particular result and does not, by itself, implicate a particular review standard.[200]

G. *The Doughboy Gets Fried*

About six weeks after *City Capital Associates*, former Justice Duffy, sitting as a judge in the Court of Chancery, took Chancellor Allen's attack on *Unocal* a huge step further in *Grand Metropolitan PLC*

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[195] *Id.*

[196] *Id.* (citing *id.* at 794):

> Ethan Allen, the Company maintains, has a unique marketing approach which is not conducive to integration of that business with Interco's other furniture businesses, Lane and Broyhill. Moreover, the Company says that Ethan Allen is not a suitable candidate for the cost cutting measures which must be undertaken in connection with the proposed restructuring.

[197] *Macmillan* Oral Decision, [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,072, at 91,024 (Del. Nov. 2, 1988).

[198] *Id.* at 91,025.

[199] *Id.*

[200] West Point-Pepperell, Inc. v. J.P. Stevens & Co., 542 A.2d 770, 780-81 (Del. Ch.), *appeal refused*, 540 A.2d 1088 (Del. 1988).

v. Pillsbury Co.[201] As in *City Capital Associates*, the target countered an all cash all shares tender offer with a restructuring and refused to redeem its poison pill.[202]

Chancellor Allen, in *City Capital Associates*, had hinted that he thought a bid that presented only the danger of inadequate shareholder value was not a "threat" for *Unocal* purposes.[203] Shareholders should have the power to decide for themselves whether to accept a bid.[204] In the event, though, he backed off this suggestion on the ground that a target board could at least suspend that shareholder power while the board arranged an alternative offering higher value.[205] Justice Duffy, though, emphasized the distinction between a threat to the corporation and a threat to shareholder value, implying that the latter was an area of less legitimate concern to the directors under *Unocal*.[206]

Further, Justice Duffy noted that the shareholder value of the target had increased greatly solely by virtue of the bid.[207] The propriety of the board's response had to be measured against such shareholder benefit and the realization that, should the bidder withdraw (and in the absence of a second entity's bid, as was the case here) that shareholder benefit "will undoubtedly vanish."[208]

The consequences of his observations go a great way toward carving out the vast bulk of takeover fights from *Unocal*. First, if

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[201]558 A.2d 1049 (Del. Ch. 1988).

[202]Grand Met made a tender offer for any and all shares of the target, Pillsbury, for $63 per share in cash to be followed by a cash out merger also at $63 per share. *Id.* at 1052. Pillsbury proposed a restructuring, which it valued at $68 per share, but which would take from two and a half to five years to implement. *Id.* at 1057. The target board refused to redeem its poison pill, preventing Grand Met's offer from succeeding. *Id.* at 1052. As Chancellor Allen did in *City Capital Associates*, Justice Duffy made an explicit finding that a rational shareholder could prefer either the bid or the management restructuring. *Id.* at 1057.

[203]City Capital Assocs. Ltd. Partnership v. Interco Inc., 551 A.2d 787, 797 (Del. Ch.), *appeal dismissed*, 566 A.2d 1070 (Del. 1988).

[204]*Id.*

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

[206]*Grand Metro.*, 558 A.2d at 1056 (Justice Duffy concluded "that no showing ha[d] been made that there would be a danger to policy or effectiveness of the Pillsbury *corporation* (that is, the *company as company*). . . . Whatever danger there [was] relate[d] solely to shareholders and that concern[ed] price only."); *see also id.* at 1056 n.8 and accompanying text (noting that there are, however, other circumstances that warrant director concern, such as: "(a) The nature and timing of the offer . . .[,] (b) Questions of illegality . . . [,] (c) The impact on constituencies other than shareholders . . . [, and] (d) The risk of nonconsummation and the quality of the securities being offered in exchange").

[207]Pillsbury' stock increased by 60%, some $1.5 billion, about $25 per share above the pre-tender offer price, solely because of Grand Metropolitan's bid. *Id.* at 1052, 1058.

[208]*Id.* at 1058.

directors cannot legitimately be as concerned with bids that pose no danger to corporate policies but only present dangers to shareholders, directors cannot easily justify interfering with such bids. In other words, they will have a harder time satisfying their burden of persuasion. That is, they will be required to show more affirmatively and clearly that their actions are, well, entirely fair. Second, all takeover fights involving only one bidder put directors in the same position as bids that present only shareholder dangers. If increased shareholder value subsists only as long as the bid, directors will have a very difficult time taking any actions that defeat that bid. Presumably, they can only meet that burden by showing that their actions are, again, entirely fair.

H. *Nancy Reagan: Not a Radically Altered State*

In most takeover situations, the target either acquiesced to the bidder's importuning, found a white knight, or offered up its own restructuring. One possibility remained: the Nancy Reagan defense.[209] TW Services, Inc. used this defense by refusing to redeem its poison pill, presenting a rather troublesome situation for the Chancellor.[210] In the face of seemingly ineluctable reason requiring *Unocal*, Chancellor Allen managed to carve yet another area out from *Unocal*'s grasp.

The bidder wanted to characterize the TW Services board as being under *Revlon* duties because, obviously, the takeover bid was higher than the market price and the target had no alternative transaction to offer.[211] In effect, this asked Chancellor Allen to hold that a company could be put involuntarily into *Revlon*, where directors were "in a radically altered state."[212] Although that result seemed to be in accord with the Chancellor's views,[213] he declined to reach the question "in light of the particularities of the circumstances."[214]

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[209]A target adopts the Nancy Reagan defense when it leaves its poison pill in place (or other already adopted defensive measure) in the face of a hostile bid without seeking any other alternative transaction. *See generally* 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 (1990) (discussing the "Nancy Reagan Defense"). The defense takes its name from Mrs. Reagan's famous admonition to children to "just say no" to drugs.

[210]TW Servs., Inc. v. SWT Acquisition Corp. (*In re* TW Servs., Inc. Shareholders' Litig.), [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334 (Del. Ch. Mar. 2, 1989), *reprinted in* 14 DEL. J. CORP. L. 1169 (1989) [*TW Servs.*].

[211]*Id.* at 92,178, *reprinted in* 14 DEL. J. CORP. L. at 1182.

[212]*Id.* at 92,179, *reprinted in* 14 DEL. J. CORP. L. at 1185.

[213]*Id.* at 92,180, 92,182 n.21, *reprinted in* 14 DEL. J. CORP. L. at 1187, 1192 n.21.

[214]*TW Servs.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,180,

What were the particularities of the circumstances? As far as I can parse the opinion, Chancellor Allen declined to reach the issue because he found the bidder's offer to be too conditional to be considered an alternative to the target's status quo.[215] Because the bid was not really an alternative, the court was not obligated to (indeed, Chancellor Allen would probably hold that the court could not) decide whether the target was under *Revlon* duties.[216]

So how did Chancellor Allen resolve this case? He did so by admitting that *Unocal* applied, and then explicitly finding it inapplicable. He admitted head on that *Moran II* held that a board's decision not to redeem the poison pill would be subject to *Unocal*.[217] He also acknowledged that Court of Chancery judges, including himself, had required targets to pull the pill.[218] In those cases the target's use of the pill for good, by giving the target time to arrange an alternative transaction, changed into use of the pill for evil and thus failed *Unocal*

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reprinted in 14 DEL. J. CORP. L. at 1187.

[215] *Id.*

[216] *Id.* at 92,182, *reprinted in* 14 DEL. J. CORP. L. at 1191. Chancellor Allen was quite cryptic in identifying the facts that made it unnecessary for him to decide the *Revlon* issue. The bid was subject to two important conditions: a typical financing condition and an Approval Condition which required the target to enter into a friendly merger agreement with the bidder. *Id.* at 92,176, *reprinted in* 14 DEL. J. CORP. L. at 1178. Chancellor Allen dilated on the Approval Condition, but never directly tied that requirement to the *Revlon* question. At the end of his opinion, after adverting, specifically, to the Approval Condition, he stated:,

> In the circumstances as they now exist [!], the board is . . . justified in not further addressing the question whether it should . . . do a current value maximizing transaction [i.e., as required by *Revlon*]; and surely before it has considered that question, it cannot be thought to have reached that stage at which it is under a duty . . . [to rescind its poison pill].

Id. at 92,182, *reprinted in* 14 DEL. J. CORP. L. at 1192. In the footnote at the end of that statement, Chancellor Allen made it clear that the financing condition would not be sufficient to deflect the *Revlon* issue and, most importantly, that he considered the question to be a legal one not a business one. *Id.* at 92,182 n.21, *reprinted in* 14 DEL. J. CORP. L. at 1192 n.21. In other words, while the target board might, in the first instance, decide whether it was under *Revlon* duties, the court would determine, wholly apart from the board's analysis, whether those duties indeed attach. *See id.*

[217] *Id.* at 92,181-82, *reprinted in* 14 DEL. J. CORP. L. at 1190.

[218] *TW Servs.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,181 nn.16-17, *reprinted in* 14 DEL. J. CORP. L. at 1188 nn.16-17 (citing Mills Acquisition Co. v. Macmillan, Inc., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,071 (Del. Ch. Oct. 17, 1988) (revised Oct. 18, 1988), *reprinted in* 14 DEL. J. CORP. L. 772 (1989), *rev'd*, 559 A.2d 1261 (Del. 1989); Grand Metro. PLC v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); City Capital Assocs. Ltd. Partnership v. Interco Inc., 551 A.2d 787 (Del. Ch.), *appeal dismissed*, 566 A.2d 1070 (Del. 1988)).

when keeping the pill in placed coerced shareholders to accept the board's preferred alternative.[219]

Just as you are convinced that Chancellor Allen has painted himself into a corner with *Unocal*, he noticed an "anomaly" that saves the day.[220] The anomaly is that the Delaware statute gives the board alone the power to initiate mergers[221] but gives the board no say over tender offers. Managements developed the poison pill to remedy that anomaly and give them power, evaluated under *Unocal*, to control tender offers as they control mergers. But if the court were reviewing a merger decision, it would not apply *Unocal* but rather the business judgment rule, assuming no board self-interest.[222] Thanks to the approval condition in this case, though, the target board is presented with *both* a merger proposal and a takeover proposal.

Stop right here. Chancellor Allen surely must have realized that since both *Unocal* and the business judgment rule were implicated, the less stringent (business judgment rule) should be applied only if it is easier to apply and the directors will fail (because one need not go on to the more stringent and more difficult-to-apply test if a party already fails the easier and less problematic test), and otherwise the more stringent (*Unocal*) should be applied. But Chancellor Allen simply ignored the problem.[223] Having mentioned that the business judgment rule applies to merger decisions and having noted that the takeover bid had a merger proposal imbedded in it, Chancellor Allen looked to the board's good faith (not questioned) and due care (not grossly negligent) and finished.[224]

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[219]*Id.* at 92,181-82, *reprinted in* 14 DEL. J. CORP. L. at 1188-92 (distinguishing factually; *Unocal* is standard to use when deciding whether to rescind the pill).

[220]In Andy Rooney fashion he asked, "Did you ever notice that mergers and tender offers are a lot alike?" Well, OK, he didn't actually put it that way. He wrote, "Public tender offers are, or rather can be, change in control transactions that are functionally similar to merger transactions with respect to the critical question of control over the corporate enterprise." *Id.* at 92,181, *reprinted in* 14 DEL. J. CORP. L. at 1189.

[221]DEL. CODE ANN. tit. 8, § 251 (1991).

[222]*TW Servs.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,182, *reprinted in* 14 DEL. J. CORP. L. at 1191-92.

[223]Chancellor Allen stated:

> The exercise of the board's power under [the merger statute] is, where there is no interested merger involved, subject to a traditional business judgment review, not the proportionality review of *Unocal*. Since [the bidder] has chosen to proceed in a way that does require exercise of the TW board's [merger] power, it cannot complain if the board's decision with respect to it is reviewed under the traditional business judgment approach.

Id.

[224]*Id.* at 92,182, *reprinted in* 14 DEL. J. CORP. L. at 1191.

I. A Kodak Moment

It seems that Chancellor Allen and some of the other members of the Court of Chancery made *Unocal* function like the entire fairness standard. But at least one other trial court judge, Vice-Chancellor Berger, saw *Unocal* in the opposite fashion.[225] In the Polaroid takeover battle she used *Unocal* as a form of the business judgment rule.[226]

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[225]In another sense, though, all the Court of Chancery judges were united in their view that *Unocal* was *not*, in function at least, a third test.

[226]There, Shamrock Holdings, Inc. announced a noncoercive all cash tender offer for Polaroid Corporation. The bid was noncoercive in the same way as in prior cases: the tender offer was for any and all shares for cash to be followed up by a cash out merger at the same price in cash. Shamrock Holdings, Inc. v. Polaroid Corp. (*In re* Polaroid Shareholders Litig.), 559 A.2d 278, 281-82 (Del. Ch. 1989) [*Polaroid II*]. Polaroid's initial response to Shamrock's bid was to increase the size of a planned employee stock ownership plan (ESOP) to give the ESOP 9.7 million of the 71.7 million outstanding shares, about 14% of the voting power. Shamrock Holdings, Inc. v. Polaroid Corp. (*In re* Polaroid Shareholders Litig.), 559 A.2d 257, 259, 265-69, 272 (Del. Ch. 1989) [*Polaroid I*]; *Polaroid II*, 559 A.2d at 281. The ESOP's purpose was to place sufficient Polaroid stock in friendly hands so that any unwanted bid would be thwarted. Vice-Chancellor Berger upheld the ESOP in *Polaroid I*. *See infra* note 227 (discussing Vice-Chancellor Berger's decision in *Polaroid I*). Shamrock also stated its intention to wage a proxy fight for the election of directors at the next annual meeting. *Polaroid II*, 559 A.2d at 285. In the course of the protracted takeover battle that followed, Polaroid management announced a plan to sell voting preferred stock to Corporate Partners, a friendly third party, and to repurchase some of its own common stock. *Id.* at 282-85. As a result, about one-third of the stock would be in friendly hands, almost surely enough to thwart Shamrock or any other unwanted suitor.

The ESOP plan and sale to Corporate Partners would increase the number of voting shares outstanding and in friendly hands. The repurchases would reduce the number of shares outstanding (increasing the percentage of friendly votes) and, incidentally, would increase the number of ESOP shares. Polaroid intended to effect the repurchase through a self tender (in which the ESOP could participate) for up to 16 million shares (22.3% of the shares outstanding) at $50 each to be followed by negotiated purchases aggregating up to $325 million from arbitragers who would tend to favor Shamrock's bid. *Id.* at 284-85, 290.

Vice-Chancellor Berger's opinions in the *Polaroid* cases are singularly unhelpful in discovering the details of the defensive mechanisms, which makes it more difficult to evaluate those mechanisms. I cannot help wondering whether that obfuscation was deliberate or whether it was simply a result of the very short time frames within which virtually all of these takeover cases were decided. The ESOP held 9.7 million of the roughly 71.7 million common shares outstanding, about 14%. *Polaroid I*, 559 A.2d at 259, 272. The shares were to be voted, through mirrored voting provisions, by the Polaroid employees who presumably would side with management against Shamrock. *Id.* at 273; *Polaroid II*, 559 A.2d at 290-91. The Preferred Stock carried voting rights at the conversion price of $50 per share, resulting in Corporate Partners holding 6 million votes. (Vice-Chancellor Berger stated that the stock voted but did not say in what ratio). *Polaroid II*, 559 A.2d at 284. That crucial datum is available from POLAROID CORP. SCHEDULE 14D-9, AMENDMENT 25 (Jan. 30, 1989), and could be inferred from at least one major newspaper story, Robert J. Cole, *$1.1 Billion Polaroid Buyback*, N.Y. TIMES, Jan. 31, 1989, at D1.) Together, the ESOP and Corporate Partners controlled about

There, Vice-Chancellor Berger distanced herself from Chancellor Allen's attempt in *Blasius Industries, Inc.* to cabin *Unocal*.[227] She did this first by denying that *Blasius Industries, Inc.* is distinct from *Unocal*[228] and then by holding that the Blasius Industries, Inc. approach was inapposite in any event because the primary purpose of the management response was not to interfere with voting rights.[229] The first aspect of her holding is simply fatuous. The second seems quite doubtful on the record presented. Vice-Chancellor Berger's conclusion that "*Blasius* . . . was not a new standard apart from *Unocal*[, but r]ather, it was a specific

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20% of the voting power before the self-tender and buy back.

The self tender would reduce the shares outstanding by 16 million to about 55.7 million, giving the ESOP and Corporate Partners at least 28% of the voting power. I would estimate at least 28% because the ESOP could increase its shareholdings by tendering and reinvesting the proceeds in Polaroid stock at the (presumably lower) market price. *See Polaroid II*, 559 A.2d at 286 n.3. If all shares were tendered (unlikely if for no other reason than that Shamrock would surely not tender its shares) then the proration number would be about 22.3% or 2,164,574 shares for total proceeds of $108,228,700. Of course, if fewer shares were tendered by other shareholders, the number purchased from the ESOP would increase. The number of additional shares the ESOP could purchase by reinvesting those proceeds would, of course, depend upon the difference between $50 and the market price and upon the ESOP's transaction costs.

The buy backs would reduce the shares outstanding by approximately 8 million (assuming the transactions were effected at an average price of $40.625, the market price at the time the plan was announced) to about 47.7 million, giving the ESOP and Corporate Partners about one-third of the total shares outstanding. *Polaroid II*, 559 A.2d at 285-86, 290. These actions were the subject of *Polaroid II*.

[227]*See* Shamrock Holdings, Inc. v. Polaroid Corp. (*In re* Polaroid Shareholders Litig.), 559 A.2d 278 (Del. Ch. 1989) [*Polaroid II*]. Although she did almost exactly the same thing herself in *Polaroid I*. *See* Shamrock Holdings, Inc. v. Polaroid Corp. (*In re* Polaroid Shareholders Litig.), 559 A.2d 257 (Del. Ch. 1989) [*Polaroid I*]. In examining the ESOP Vice-Chancellor Berger found that *Unocal* was not met but she approved the board's action on the ground that the board had shown entire fairness. *Id.* at 271, 274. When one truly looks at the result, though, Vice-Chancellor Berger neatly sidestepped any application of *Unocal*. She recognized that the parties vigorously contested the applicable standard of review. *Id.* at 270. But without making a specific finding that any standard applied, the Vice-Chancellor looked to see whether the board's action in adopting the ESOP was entirely fair on the theory that the question of which standard is applicable is irrelevant if the transaction meets the most rigorous standard. *Polaroid I*, 559 A.2d at 271. (Incidentally, her logic seems at odds with *Revlon* because she finds that board action that fails *Unocal* is not per se impermissible but is scrutinized under entire fairness. Justice Moore's *Revlon* opinion is clearly contrary on this issue.) To dilate momentarily, the Vice-Chancellor did not make a finding that entire fairness is the appropriate standard. She simply said that the choice of standard is irrelevant if the challenged transaction passes muster under the most rigorous standard. *Polaroid I*, 559 A.2d at 271. After looking at the totality of the circumstances, the Vice-Chancellor found that the directors had demonstrated entire fairness. *Id.* at 275-76.

[228]*Polaroid II*, 559 A.2d at 285-86.

[229]*Id.* at 286.

expression of the proportionality test as applied to conduct that effectively precluded the election of directors,"[230] is smack dab diametrical from the Chancellor's resolution of the very question: "Does this rule [*Unocal*] . . . apply to action designed for the primary purpose of interfering with the effectiveness of a stockholder vote?"[231] The Chancellor stated that "[o]ur authorities, as well as sound principles, suggest that . . . that rule not be applied . . . ."[232]

As to the second finding, that the primary purpose of the Polaroid management response was not to interfere with a stockholder vote,[233] Vice-Chancellor Berger made the conclusion turn entirely upon whether the success of management's plan would preclude Shamrock from winning its proxy fight. In my view, Vice-Chancellor Berger mischaracterized *Blasius Industries, Inc.* by saying that the board's primary purpose there was inferred mostly from the timing and from the preclusive effect of the board actions.[234] In reality, that finding was based principally upon the board's actual intent; the Chancellor did not infer intent from the timing, preclusive nature, or any other indirect evidence.[235]

Examining the preclusive effect and timing, Vice-Chancellor Berger decided that even with the management actions Shamrock would go into any director election with about a third of the votes (9.6% it owned, and 22% from the arbitragers who would likely side with Shamrock) which would be about equal to the votes controlled by management.[236] The timing of the management plan was "much less suspicious" than in *Blasius Industries, Inc.* because, even though the transactions were crystallized and made public only ten days after Shamrock announced its proxy fight,[237] management had been thinking about it long before.[238] In *Blasius Industries, Inc.*, management had been

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[230] *Id.*

[231] Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988).

[232] *Id.*

[233] *Polaroid II*, 559 A.2d at 285.

[234] *Id.* at 286.

[235] *Blasius Indus., Inc.*, 564 A.2d at 655-56 ("[T]he members of the board realized that they were thereby precluding the holders of a majority of the Company's shares from placing a majority of new directors on the board. . . . Indeed the evidence establishes that that was the principal motivation in so acting.").

[236] *Polaroid II*, 559 A.2d at 286.

[237] *Id.* at 286.

[238] *Id.* The Vice-Chancellor stated that "[t]he record at this point indicates that the Management Transactions were being considered, reviewed and, in the case of the Preferred Stock issuance, negotiated, for several weeks, if not months, before Shamrock announced the proxy contest." *Id.*

thinking about expanding the board long before it actually did so, and it clearly expanded its board in response to the bidder.[239] Much less suspicious, indeed!

Having wished away *Blasius Industries, Inc.*, Vice-Chancellor Berger turned to *Unocal* itself. After finding that the Polaroid board acted in good faith and after reasonable investigation,[240] she was faced with the same issue as in *City Capital Associates* and *Grand Metropolitan*: whether a noncoercive but arguably inadequate offer can be a threat under *Unocal*.[241] Vice-Chancellor Berger agreed with Chancellor Allen that ordinarily such a setting makes finding a threat dubious.[242] Nonetheless, she found a threat here in the possibility that Polaroid shareholders might be unable to value their stock appropriately.[243] How might this happen? Well, Kodak had been found liable to Polaroid for patent infringement and the damages trial was beginning.[244] Ordinary shareholders had "very little way of assessing the present worth" of this trial.[245]

This conclusion seems untenable to me. My objections are two. One is based on the particular facts of this case, while the second goes much deeper and is based on the generalization of Vice-Chancellor Berger's conclusion. First, shareholders did have ways of valuing the claim against Kodak. Shareholders who followed even the most accessible of the business publications could read of various estimates.[246] For shareholders who were True Believers,[247] the daily stock price

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[239]*Blasius Indus., Inc.*, 564 A.2d at 655 (target CEO approached an acquaintance about board service over a year before the takeover bid but followed through only as the bid developed).

[240]*Polaroid II*, 559 A.2d at 287.

[241]*Id.*

[242]*Id.* at 289.

[243]*Id.* at 290.

[244]*Polaroid II*, 559 A.2d at 289 (stating that "the damages trial is scheduled to begin in April [1989]"). Polaroid was suing for damages in the amount of $5.7 billion. *Id.*

[245]*Id.* at 290.

[246]*See, e.g.*, Cole, *supra* note 226, at D19 (stating that in the "trial to set damages, . . . Polaroid has sought $5.7 billion in damages"); Floyd Norris, *The Polaroid Defense: A Potential Classic*, N.Y. TIMES, Feb. 24, 1989, at D1, D8 (stating that "the suit could produce a large payout to shareholders within a year or two"); *Polaroid-Kodak Trial Is Delayed*, N.Y. TIMES, Jan. 19, 1989, at D5 (stating that "[a]nalysts have estimated that damages against Kodak could run as high as $1 billion); Richard W. Stevenson, *Shamrock Lifts Bid for Polaroid*, N.Y. TIMES, Jan. 20, 1989, at D4 (stating that "Wall Street's estimates of the award range from $500 million to several billion dollars").

[247]I am here referring to true believers in the Efficient Capital Market Hypothesis (ECMH) for the random nature of stock price movements.

represented the most reliable valuation of Polaroid's future prospects, including the claim against Kodak.

Further, two additional kinds of data provided investors with unusually reliable information on which to make their own valuation conclusions. Most concretely, shareholders had Polaroid's own discussion of the Kodak litigation in the self-tender documents sent to all shareholders.[248] While Polaroid included the usual disclaimers and shied away from prediction, the range of possibilities was from $400 million to $6.4 billion.[249] Also, a sophisticated party, Corporate Partners, had just negotiated at arm's length the purchase of a significant amount of Polaroid equity.[250] Professional investors and knowledgeable individual investors could work backwards from the price, expected returns, and other terms of that sale to come to some conclusions about the value of Polaroid equity. For the True Believers, of course, this data not only provided a way for individuals to come to independent valuation conclusions,[251] they were quickly impounded in Polaroid's stock price, making the market price an even more accurate reflection of Polaroid's prospects.[252]

My second objection to Vice-Chancellor Berger's finding that the Polaroid board could perceive a threat from concern that shareholders would be unable to reach an accurate judgment about Polaroid's value[253] is more general. She said that, even with the ECMH, newspapers, and any other information, Polaroid's shareholders did not have much ability to discover the present value of a major asset (the Kodak recovery) and so might undervalue that asset.[254] Where to begin? With the most obvious hole, I guess, which is clearly her bias in favor of management and against the bidder. Was there not also a danger that shareholders might *over*value the recovery against Kodak? Vice-Chancellor Berger never mentioned that possibility, but the consequences of overvaluing versus undervaluing are clear. Shareholders who undervalue a company

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[248]*Polaroid II*, 559 A.2d at 289.

[249]*Id.* at 289-90.

[250]*Id.* at 282-83 ("[T]he Polaroid board met and approved the sale of $300 million in Preferred Stock to Corporate Partners."). "Corporate Partners actually invested only $253 million of the $300 million." *Id.* at 283 n.2.

[251]A task of sheer folly to True Believers because undertaking it only increases costs but cannot increase return since Polaroid's stock is never overvalued or undervalued.

[252]My apologies to True Believers for implying that the ECMH could ever be less than accurate.

[253]*Polaroid II*, 559 A.2d at 290.

[254]*Id.* Vice-Chancellor Berger stated that "there is a real possibility that the Polaroid stockholders will undervalue the Kodak judgment and it does not appear that the mere dissemination of information will cure this problem." *Id.*

are more likely to tender to the raider because they believe the tender consideration represents a higher percentage of the company's present value.[255] In contrast, those who overvalue are more likely to reject the tender consideration as inadequate because, in their minds, the consideration represents a smaller percentage of the company's present value.

Most centrally, though, think about the consequences of Vice-Chancellor Berger's logic. She said that because the future is uncertain,[256] shareholders might misvalue the company and so might take action that proves unwise.[257] Well, almost all of life comes down to making decisions on imperfect information. If management can legitimately perceive a threat under *Unocal* whenever a decision maker[258] acts under conditions of uncertainty, then a threat always exists. To twist a central phrase from *Unocal*, there would be an omnipresent specter that a board may be acting without certain knowledge about the future.

So, a *Unocal* threat always exists. That still leaves the second half of *Unocal*, proportionality. Here, as I have suggested, Vice-Chancellor Berger joined her Court of Chancery colleagues in not treating *Unocal* as a third standard; unlike her colleagues, she made *Unocal* equivalent to the business judgment rule. Under *Unocal*, you will recall, the *board* must show that its response was *reasonable* in relation to the threat posed. Vice-Chancellor Berger subtly but clearly inverted that rule. In *Polaroid II*, it is the *plaintiff* who must show that the board action was *impermissible*,[259] precisely the business judgment rule standard.

A look at her language shows that her inquiry is almost totally business judgment rule.[260] "If viewed in isolation, it would be difficult

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[255] *Id.* at 289 ("[T]he threat is that the stockholders might choose the inadequate tender offer only because the superior option has not yet been presented.").

[256] *Id.* at 290 (explaining that "in light of the current status of the Kodak litigation," "facts will not be known until the Kodak litigation runs its course"). "In sum, Polaroid is anticipating a monetary recovery. . . ." *Id.* "In the foreseeable future, the amount of the damage award will be quantified if not paid." *Id.*

[257] *Polaroid II*, 559 A.2d at 290 ("[T]here is a valid basis for concern that the Polaroid stockholders will be unable to reach an accurate judgment as to intrinsic value of their stock in light of the current status of the Kodak litigation.").

[258] Presumably Vice-Chancellor Berger's observation about acting on imperfect information would apply to the board as well as shareholders.

[259] *Id.* (stating that "I remain unpersuaded that the employee stockholders constitute a monolithic block of voters who, for one reason or another, are constrained to vote with management").

[260] The one exception in her analysis is when she draws an analogy to *AC Acquisitions* by saying that a management response that allows shareholders to choose between alternatives has been found to be an "appropriate response." *Id.* That, she said, is the situation here, if one

to find that the self-tender and buy-back constitute an *un*reasonable response."[261] Turning to the ESOP, she "remain[ed] unpersuaded" *by plaintiff*[262] that the ESOP was impermissible because she did not believe the employees would necessarily vote with management.[263] The capstone is this: "In sum, . . . I am unable to conclude preliminarily that either the Corporate Partners transaction alone or the Management Transactions as a whole are *un*reasonable either because they are *dis*proportionate to the Shamrock threat or because they were improperly motivated."[264]

V.

By now the Delaware Supreme Court had had enough of the Court of Chancery's interpretations of *Unocal*. It had been a year and a half since Justice Moore or any other Delaware Supreme Court Justice had anything to say about *Unocal* and the life it was living. The next ten months were to see Justice Moore, Chancellor Allen, and Justice Horsey make the sharpest, most divergent pronouncements about *Unocal*. This, then, was the first real gloves off interpretation of *Unocal* and its holding. When they were finished, four years would pass before another judge had something of real importance to say in the life of *Unocal*.

A. *Thank You, Obi-Wan*

It started with Justice Moore's opinion in *Mills Acquisition Co. v. Macmillan, Inc.*[265] trying to clean up a rather nebulous decision by Vice-Chancellor Jacobs. Macmillan, Inc., which had seen its plan to escape the Bass family thwarted in *Robert M. Bass Group*,[266] was now being

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ignores the ESOP and Corporate Partners transactions. *Id.*

[261] *Polaroid II*, 559 A.2d at 290 (emphasis added).

[262] *Id.* at 279 (explaining that plaintiffs had "filed actions attacking the validity of an employee stock ownership plan ('ESOP') adopted by Polaroid").

[263] *Id.* at 290.

[264] *Id.* at 291 (emphasis added).

[265] 559 A.2d 1261 (Del. 1989).

[266] 552 A.2d 1227 (Del. Ch. 1988). "[T]he Bass Group made . . . an offer to acquire all of Macmillan's common stock for $64 per share cash." *Id.* at 1234. "[T]he [Macmillan] Board [had] determined that the Bass Group's history and the volatile market situation constituted a threat to Macmillan and its shareholders." *Id.* at 1232. The Macmillan directors responded to the Bass offer with a restructuring plan. *Id.* at 1234-36. The Board found that "the $64 Bass Group proposal was unfair and inferior to the restructuring." *Id.* at 1236. "[T]he full Board voted, to adopt the restructuring and to reject the Bass Group proposal." *Id.* However, the Court of Chancery found that "the restructuring is an unreasonable response under *Unocal* [the Bass offer]." *Id.* at 1244. The court granted a preliminary injunction. *Id.*

pursued by Robert Maxwell, the English media boss.[267] Maxwell entered the bidding at a price too rich for the Bass family shortly after Vice-Chancellor Jacobs forced Macmillan to postpone its restructuring.[268]

This much is certain from Justice Moore's opinion in *Macmillan*: the Macmillan board was under *Revlon* duties,[269] its actions were judged under the intrinsic fairness test,[270] and they were found to violate the requirement of fair dealing.[271] Almost nothing else is clear from that opinion. For instance, while Justice Moore spent a considerable amount of space talking about the fair dealing aspect of intrinsic fairness, nowhere did he address the question whether the ultimate price paid by the winning bid was fair in either an absolute sense or a relative one *vis-à-vis* the other bidder.

More importantly for *Unocal*, did intrinsic fairness apply because *Revlon* applied or because of director self-interest or both? Consider these two statements made a page apart:

> Our decision in [*Revlon*] requires the most scrupulous adherence to ordinary standards of fairness in the interest of promoting the highest values reasonably attainable for the stockholders' benefit.[272]

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at 1247.

[267]*Macmillan*, 559 A.2d at 1272 n.18 ("the entry of Maxwell into the fray, for all practical purposes, rendered the Bass bid academic").

[268]Literally within hours of Vice-Chancellor Jacobs' decision in *Robert M. Bass Group*, the two controlling executives of Macmillan authorized a sale of the company if it were to an acceptable party and if a larger equity position were granted to the two executives and their clique. *Id.* at 1272. Over the next 10 weeks or so, Maxwell competed with a proposal by Kohlberg Kravis Roberts & Co. (KKR) that included the key Macmillan executives. *Id.* The negotiating process, which included a multi-round auction, was badly tainted in favor of the KKR/management group which finally signed a sale agreement with the Macmillan board. Mills Acquisition Co. v. Macmillan, Inc., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,071, at 91,011-3 to 91,012 (Del. Ch. Oct. 17, 1988) (revised Oct. 18, 1988), *reprinted in* 14 DEL. J. CORP. L. 772, 777-78 (1989), *rev'd*, 550 A.2d 35 (Del. 1988). Vice-Chancellor Jacobs refused to enjoin the agreement, though, finding that nothing in the evidence suggested that Maxwell had not submitted its best bid which was, admittedly, inferior to the KKR/management bid. *Id.* at 91,023-24, *reprinted in* 14 DEL. J. CORP. L. at 800-02. He did require Macmillan to redeem its poison pill if Maxwell announced a higher bid which it claimed it would do. *Id.* at 91,024, *reprinted in* 14 DEL. J. CORP. L. at 803.

[269]*Macmillan*, 559 A.2d at 1280.

[270]*Id.* at 1265.

[271]*Id.* at 1280-83.

[272]*Id.* at 1264.

> With the divided loyalties that existed on the part of certain directors, and the absence of any serious oversight by the allegedly independent directors, the governing standard was one of intrinsic fairness.[273]

Obviously, Justice Moore could and probably should have stopped once he determined that intrinsic fairness applied and was not met. But here was the first time in months he could say anything about *Unocal* and he did so, even though his statements were simply dehors to the merits of the case. Again, he is contradictory within a few paragraphs about the relation of *Unocal*, *Revlon*, intrinsic fairness, and the business judgment rule.

Justice Moore started with the proposition that *Unocal* applies whenever *Revlon* duties attach unless a true conflict of interest warrants intrinsic fairness.[274] Then, in a swipe at Chancellor Allen, he magnanimously allowed that, while the Court of Chancery judges may not have explicitly applied *Unocal* when evaluating *Revlon* duties, they have in fact done so and, by the way, any confusion is one of semantics rather than substance.[275]

Fair enough. But wait, Justice Moore has more clarifying to do. Unfortunately, it was not very helpful. Here was his opportunity to clarify a major conundrum but he let it pass. Two problems prevent *Unocal* from being applied reflexively to *Revlon* settings. First, if the conceptual motivation for *Unocal* were the omnipresent spectre of self-

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[273] *Macmillan*, 559 A.2d at 1265.

[274] *Macmillan*, 559 A.2d at 1287. "In the absence of self-interest, and upon meeting the enhanced duty mandated by *Unocal*, the actions of an independent board of directors in designing and conducting a corporate auction are protected by the business judgment rule." *Id.* (citing Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1341 (Del. 1987)).

[275] *Id.* at 1287-88. Justice Moore stated:

> It is not altogether clear that, since our decision in *Revlon*, the Court of Chancery has *explicitly* applied the enhanced *Unocal* standards in reviewing such board actions. . . . [I]t seems that there has been a *de facto* application of the *enhanced* business judgment rule under *Unocal*. To the extent that this has caused confusion, we think it is more a matter of semantics than of substance.

Id. at 1287-88. (citing Chancellor Allen's opinions in *In re* RJR Nabisco, Inc. Shareholders' Litig., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,194 (Del. Ch. Jan. 31, 1989), *reprinted in* 14 DEL. J. CORP. L. 1132 (1989); West Point-Pepperell, Inc. v. J.P. Stevens & Co., 542 A.2d 770 (Del. Ch. 1988); *In re* Fort Howard Corp. Shareholders' Litig., No. 9991, 1988 Del. Ch. LEXIS 110 (Del. Ch. Aug. 8, 1988), *reprinted in* 14 DEL. J. CORP. L. 699 (1989) (similar issue and disposition to *J.P. Stevens*); and Vice-Chancellor Hartnett's opinion in *In re* Holly Farms Corp. Shareholders' Litig., [1988-1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,181 (Del. Ch. Dec. 30, 1988), *reprinted in* 14 DEL. J. CORP. L. 1062 (1989)).

interest, that motivation pretty clearly has disappeared when the company is to be sold, unless the directors are to retain their jobs in which case, intrinsic fairness applies.[276] Second, asking the *Unocal* questions does not seem to get the kind of answers that will be useful in deciding whether *Revlon* duties were met. In other words, if we want to know, as we do under *Revlon*, whether the directors took action designed to get the highest value reasonably available, why do we ask whether the directors reasonably perceived a harm to corporate policy and whether their reaction was reasonable in relation to that harm?

Justice Moore talked about neither issue except to say, "as we recognized in *Revlon*, the two part threshold test, of necessity is slightly different."[277] What does slightly different mean? Well, when *Revlon* applies, the plaintiff first has to show that the target treated the bidders unequally.[278] Then *Unocal* requires that the court decide whether directors properly perceived that shareholder interests were enhanced by that treatment and, if so, whether the actions were reasonable in relation to the advantage sought or threat posed.[279] As near as I can tell, the only similarities between this test for evaluating *Revlon* duties and *Unocal* is that they both have two parts. The trigger is different[280] and the questions are different. So, the question of what it means to apply *Unocal* in *Revlon* settings has pretty much become a dog's breakfast.

Hold on a minute. Wasn't Justice Moore pretty clear that *Unocal* always applies to *Revlon* cases? I thought so too. But what then is the import of the language, not a paragraph later which states: "It is only then [i.e., after a finding of disparate treatment] that the two-part threshold requirement of *Unocal* is truly invoked."?[281] Suppose the bidders are treated equally, does *Unocal* apply, or not? If so, is it the real *Unocal* or this "slightly different" one? If not *Unocal*, is the implication that the business judgment rule applies unless some real conflict triggers intrinsic fairness?

So, *Macmillan* comes down to this: intrinsic fairness applies on these facts though we are not sure precisely why. The board was unable to show fair dealing but there is no discussion of fair price which was the

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[276]Why it is that a director's desire to keep his or her directorship is such a significant conflict as to trigger intrinsic fairness in *Revlon* settings but insufficient to trigger intrinsic fairness where the target simply fends off a raider is a complete mystery to me.

[277]*Macmillan*, 559 A.2d at 1288.

[278]*Id.*

[279]*Id.*

[280]*Unocal* is triggered whenever the board takes a defensive action. This test is triggered when plaintiff shows disparate treatment among bidders.

[281]*Macmillan*, 559 A.2d at 1288.

determining issue in the Court of Chancery. Unless intrinsic fairness applies, *Unocal* applies to *Revlon* cases but maybe not if the bidders were treated equally and in that case Justice Moore does not tell us what standard to use. When we say *Unocal* applies to *Revlon*, though, we mean a two-part test with a different policy motivation and different inquiries than the original *Unocal*.

Thank you, Obi-Wan.

B. *Eunucal*

Although no one could have known it then, the battle for Time Incorporated represented both the apotheosis of the 1980's takeover struggle[282] and the joining of the ultimate issue about *Unocal*. The Delaware Supreme Court faced the resolution of the existential debate: was *Unocal* something other than business judgment rule or entire fairness? Chancellor Allen's stunningly constructed opinion in *Time I*[283] placed the matter squarely in the hands of the Delaware Supreme Court to do what it seemed it had always wanted to do. That is, Chancellor Allen gave the supreme court the opportunity to make *Unocal* exactly equivalent to one of the preexisting tests.

The Time facts[284] and the Chancellor's opinion forced the supreme

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[282]These struggles "peaked in dollar value in 1988 and 1989 and [were] clearly over by 1991." RONALD J. GILSON & BERNARD S. BLACK, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 37 (2d ed. 1995).

[283]Paramount Communications, Inc. v. Time Inc. (*In re* Time Inc. Shareholders' Litig.), [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,264 (Del. Ch. July 14, 1989) (revised July 17, 1989) [*Time I*], *reprinted in* 15 DEL. J. CORP. L. 700 (1990), *aff'd*, 571 A.2d 1140 (Del. 1990) [*Time II*].

[284]Time believed that it had to diversify to provide increased global competition and to acquire products for its cable television channels and franchises. *Id.* at 93,267, *reprinted in* 15 DEL. J. CORP. L. at 711. After methodically canvassing potential partners, Time decided that Warner Communications Inc. presented the best long term match. *Id.* at 93,267-3, *reprinted in* 15 DEL. J. CORP. L. at 713. The deal was initially structured as a reverse triangular merger between Warner and a Time subsidiary. *Id.* at 93,270, *reprinted in* 15 DEL. J. CORP. L. at 718. Warner shareholders would receive Time stock at a premium to the prevailing Time-Warner ratio. *Time II*, 571 A.2d at 1146. About 62% of the stock would be owned by former Warner shareholders after the merger but an unknown number of such shareholders also held stock in Time prior to the merger. *Id.* at 1146 & n.7. The boards were to be combined equally, as were the senior managements. *See id.* at 1146. The heads of Time and Warner were to be co-CEOs for five years when the former head of Warner was to retire, leaving the former head of Time as the sole CEO. *Id.* Although Delaware law did not require Time shareholders to vote, the New York Stock Exchange required a favorable shareholder vote because of the dilution that would occur. *Id.* Time stock rose about 8% to the low $120s following the announcement of the Warner deal. *Time I*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,271, *reprinted in* 15 DEL. J. CORP. L. at 720-21.

court to take a precisely contrary tack than had ever been presented before. Chancellor Allen said *Unocal* covers every takeover action and *Unocal* is the business judgment rule. In that way he challenged the supreme court to make something else out of *Unocal*. Would it hew to its original intent and discredit its holding in *Pogostin*, making *Unocal* really the intrinsic fairness test? If not, would it distinguish *Unocal* from the business judgment rule by explicitly limning the ways in which a greater scrutiny was necessary? The consequence of not doing so would be enormous. If the supreme court sustained Chancellor Allen's interpretation, virtually every takeover action would receive substantial deference except where the target agreed to combine with a buyer whose stock was controlled by a single person or group.

In the event, Justice Horsey, with Justice Moore and Justice Holland on the panel, caved into Chancellor Allen's challenge. Justice Horsey's opinion sustained the Chancellor's characterization of *Unocal* completely. After *Time II* target managements felt they had almost total freedom to take defensive actions and to make strategic combinations with other companies freed from any substantial scrutiny by the Delaware courts. The enormity of *Time II* was insistent. It would take four years for the dismantling to begin, but by 1994 the Delaware judges realized that *Time II* must be undone and that Chancellor Allen's position that *Unocal* is a chimera was right.

After the proxy materials were sent, Paramount Communications, Inc. announced an all cash all shares tender offer for Time at $175 per share conditioned, among other things, on Time not combining with Warner. *Id.* at 93,271, *reprinted in* 15 DEL. J. CORP. L. at 720. Time stock jumped an additional 35% to $170 on the day Paramount announced its tender offer. *Id.* at 93,271, *reprinted in* 15 DEL. J. CORP. L. at 721. Time and Warner recast their deal to eliminate the Time shareholder vote which seemed unlikely to be favorable. *Id.* at 93,272, *reprinted in* 15 DEL. J. CORP. L. at 722. Under the revised transaction, Time, through a subsidiary, would make a Warner-approved cash tender offer for Warner stock to be followed by a cash out merger. *Id.* No Time shareholder vote was necessary under either Delaware law or the New York Stock Exchange. Time would incur seven to ten billion dollars of new debt to raise the cash necessary to buy out the Warner shareholders. *Time II*, 571 A.2d at 1148. Although Warner shareholders would no longer participate in the equity of the combined enterprise, the board and management aspects of the original transaction remained intact. *See id.*

To increase the pressure on the Time board, Paramount raised its offer to $200 per share. *Id.* at 1149. Time's own investment banker, Wasserstein, Perella, opined that Time shares would trade following the Time-Warner stock combination at around $150 and perhaps as high as $175. *Time I*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,272-73, *reprinted in* 15 DEL. J. CORP. L. at 724. Time essentially conceded that Paramount's offer (even the original $175 offer) was higher than the likely current value of Time shares after combining with Warner. Time believed that, in the longer run, its shares would trade at a higher price than Paramount was currently offering. *Id.*

Structurally, Chancellor Allen's opinion is a tad nonlinear, as though he didn't want to give away the consequences of his decision. In a key paragraph he *poses* two issues, *Revlon* and *Unocal*. Then he *describes* the *Revlon* issue in about half a dozen paragraphs and *describes* the *Unocal* issue in two paragraphs. After that, he *analyzes* each issue, seriatim, in lengthy sections.[285] Each succeeding discussion goes into more depth and the alternation between issues seems calculated to lead one by degrees to conclusions that might not be clear or palatable were one presented with the logic all at once.

When each issue is spliced together, Chancellor Allen's boldness becomes clear. He started by observing that boards can in good faith believe that the current price does not accurately value shares. He then invoked *Revlon*, saying that boards are under no duty to maximize present share value unless *Revlon* duties attach. At a minimum, boards take on *Revlon* duties when they agree to transactions involving a change of control. Here, in an apparent affront to Justice Moore, Chancellor Allen carefully cited precisely the same four cases discredited in *Macmillan*.[286] If the Chancellor had wanted to find a change in control he surely could have done so. From either a shareholder standpoint or a management standpoint, Time Inc.'s combination with Warner could readily have been a change of control. Time shareholders would own only 38% of the stock, would not have a majority of the board seats, and would not clearly have the CEO position for five years.

When given the opportunity in the past, Chancellor Allen carved out of *Unocal* as many settings as possible. Here was another chance. If *Revlon* duties did not attach, *Unocal* surely did. So, did the Chancellor find a change of control triggering *Revlon*? No. He based his holding that *Revlon* was not invoked strictly on an examination of the shareholders' status. He disingenuously finessed any question of whether a change in board or senior management composition could be a change of control for *Revlon* purposes.[287] Instead, Chancellor Allen found no

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[285]The key paragraph is at *Time I*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,276, *reprinted in* 15 DEL. J. CORP. L. at 732. The description of the *Revlon* issue is at *id.* at 93,276-78, *reprinted in* 15 DEL. J. CORP. L. at 732-35 (Part III.A) and the *Unocal* description is at *id.* at 93,278, *reprinted in* 15 DEL. J. CORP. L. at 735-36 (Part III.B). The *Revlon* analysis is in Part IV. *See id.* at 93,278-81, *reprinted in* 15 DEL. J. CORP. L. at 736-42. The *Unocal* analysis is in Part V. *See id.* at 93,281-84, *reprinted in* 15 DEL. J. CORP. L. at 742-49.

[286]*Time I*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,277 & n.16, *reprinted in* 15 DEL. J. CORP. L. at 734 & n.16.

[287]"[A]side from legal technicalities and aside from arrangements thought to enhance the prospect for the ultimate succession of [Time's CEO], neither corporation could be said to

change of control because the shareholders did not, in any meaningful sense, control Time before the transaction. Therefore, it would be irrelevant that they would not do so after the Warner combination.[288]

Chancellor Allen was curiously formalistic on the question of control. Practical control in the sense of locating the person or group that can direct the policy of the corporation seems immaterial to the Chancellor. That control pretty clearly shifts from Time alone to an equal sharing between Time and Warner. Chancellor Allen looked only to control in a formal sense asking in effect, "who can elect the board which is charged with formulating policy?" But then the answer to that question is again answered in a practical sense. Formally, Time shareholders went from 100% control in the aggregate to 38%. Practically, said the Chancellor, Time shareholders did not exert any control at all and, after the combination, no shareholder group would exercise control so no change of control occurred.[289]

This, of course, leaves *Unocal*, which Chancellor Allen abstracts, to the question whether the board or the shareholders should make the choice between Warner and Paramount.[290] Two lines of logic suggested that the shareholders should make that choice. One line is rooted in *Blasius Industries, Inc.* and the notion that shareholder voting cannot be infringed except in extreme circumstances. The other line of logic is the set of Court of Chancery decisions requiring targets to allow shareholders to choose (in nonvoting contexts) between alternative transactions.[291] The first line, of course, is the situation the Chancellor specifically carved out of *Unocal*. In the second line are cases finding that *Unocal* was not met. Although Chancellor Allen was not explicit, it seems clear that if *Unocal*

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be acquiring the other." *Id.* at 92,279-80, *reprinted in* 15 DEL. J. CORP. L. at 739.

[288]In the Chancellor's words, "Control of both [companies] remained in a large, fluid, changeable and changing market." *Id.* at 93,280, *reprinted in* 15 DEL. J. CORP. L. at 739.

[289]One set of plaintiffs made a rather sophisticated argument for *Revlon*: *Revlon* duties were triggered because the Time-Warner combination would as a practical matter preclude the Time shareholders from ever receiving a control premium. *Id.* at 93,280-81, *reprinted in* 15 DEL. J. CORP. L. at 741-42. That consequence should impose upon the Time board the duty to maximize the current share value now under *Revlon*. *Id.* Chancellor Allen dismissed this argument by simply noting that it would extend *Revlon* beyond its limits! *See id.*

[290]*Time I*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,276, *reprinted in* 15 DEL. J. CORP. L. at 731.

[291]Chancellor Allen cited Grand Metro. PLC v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); City Capital Assocs. Ltd. Partnership v. Interco Inc., 551 A.2d 787 (Del. Ch.), *appeal dismissed*, 566 A.2d 1070 (Del. 1988); 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). *Time I*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,278, *reprinted in* 15 DEL. J. CORP. L. at 735-36.

applies, and if it is met, the board can preclude shareholder choice without any overt consideration of whether the shareholders should be the constituency to make such a choice.

As with the *Revlon* question, Chancellor Allen seems eager to reach *Unocal* when he could just as easily have avoided doing so. The Time board restructured the Warner transaction intentionally to eliminate the Time shareholder vote which would have occurred in the original agreement. The linchpin to the revised transaction's success was that the shareholders would not vote on the Time-Warner combination; were they to vote they almost surely would have rejected the combination. Yet *Blasius Industries, Inc.* was not implicated because the vote under the original transaction was not required under Delaware statutes, only by the New York Stock Exchange (NYSE). The initial transaction could have been effected without a shareholder vote if the companies had been content to have the stock trade somewhere other than the NYSE.

It would seem congruous with *Blasius Industries, Inc.*'s emphasis on the franchise to find that, no matter why a vote was provided for, once a transaction involving a vote was put in motion a change, and most especially a change designed for the very purpose, that eliminated the vote would trigger the "exceptional circumstances" test, equivalent to intrinsic fairness, of *Blasius Industries, Inc.* But no, Chancellor Allen cabined *Blasius Industries, Inc.* in a way that was not contemplated in the original decision. Now, Chancellor Allen has presented *Unocal* squarely.

The Chancellor emphasized that *Unocal* applies to all defensive measures whether prophylactic or in response to actual takeover bids.[292] Now for the *coup de grâce*. The Chancellor eviscerated *Unocal* by holding that, in effect, a threat to corporate policy and effectiveness always exists by an unwanted takeover bid for a going concern. The original transaction was not defensive and, although the revision was defensive, the end result — the combination of Time and Warner — was the same as the original intention. Paramount's bid, then, was a threat for *Unocal* purposes. This is true even though the board took the possibility of an unwanted bid into account when formulating its original plan. Chancellor Allen was careful not to place his decision on the fact that the Time-Warner combination was an extraordinary combination. At one point he described the dichotomy as being between "*bona fide* strategic business planning" and "questions of corporate control."[293] Shortly thereafter, he described the corporate policy being threatened as

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[292]Time I, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,282, *reprinted in* 15 DEL. J. CORP. L. at 745.

[293]*Id.* at 93,283, *reprinted in* 15 DEL. J. CORP. L. at 747.

"achievement of the long-term strategic plan."[294] He crystallized his holding by saying that where a board does not explicitly assume *Revlon* duties, "but continues to manage the corporation for long-term profit pursuant to a preexisting business plan that itself is not primarily a control device or scheme, the corporation has a legally cognizable interest in achieving that plan."[295] In other words, assuming the target had any sort of explicit business plan, which every corporation surely has, an unwanted bid is a threat. The first half of *Unocal* has been turned into total deference to the target board. Proof that Chancellor Allen knew what he was doing is in the case he said was most analogous to this: *Polaroid II*.[296]

That still left *Unocal*'s proportionality aspect to consider. If the utterness of Chancellor Allen's capitulation had escaped notice, the tenor of his proportionality discussion would leave no doubt. He warned that we must be cautious in applying *Unocal*, lest the benefits of the business judgment rule be lost![297] In only one paragraph of discussion the obvious end is told. The revision to the original agreement is reasonable because it is "not overly broad."[298] Not overly broad, but effective nonetheless. The only setting Chancellor Allen suggested might be unreasonable is where a takeover is actually precluded.[299]

Well, there is Chancellor Allen's capitulation on *Unocal*. After *Time I*, *Unocal* applies in almost every takeover setting and it is abject deference to the target board's decisions. Chancellor Allen has ceased resisting and pushed *Unocal* to the opposite limits from his original inclination. Was this a ploy to make the Delaware Supreme Court back away? Was it, in his own words in the *Time I* peroration,[300] brilliantly prescient or dismayingly wrong?

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[294] *Id.*

[295] *Id.*

[296] *Time I*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,283, *reprinted in* 15 DEL. J. CORP. L. at 748.

[297] *Id.* at 93,283-84, *reprinted in* 15 DEL. J. CORP. L. at 748.

[298] *Id.* at 93,284, *reprinted in* 15 DEL. J. CORP. L. at 749. The Chancellor pretended that he might have ruled differently if the poison pill were an issue, which it was not. The pill was irrelevant because when Paramount raised its offer from $175 to $200 it was required by SEC rules to extend the date on which it could take down shares. The new purchase date was after the date Time could purchase Warner shares under its revised transaction. *See id.* at 93,284 n.22, *reprinted in* 15 DEL. J. CORP. L. at 749 n.22. Nonetheless, I think that he made such a point of distinguishing the poison pill cases that if the pill had been an issue here he would have reached the same result. *See id.* at 93,283, *reprinted in* 15 DEL. J. CORP. L. at 747.

[299] *Id.* at 93,284, *reprinted in* 15 DEL. J. CORP. L. at 749.

[300] *Time I*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,514, at 93,284, *reprinted in* 15 DEL. J. CORP. L. at 750.

C. *Brilliantly Prescient and Dismayingly Wrong*

Chancellor Allen was brilliantly prescient. Justice Horsey was dismayingly wrong. Chancellor Allen circumscribed *Revlon* to situations where either an explicit sale or a change of control to a discrete shareholder or shareholder group takes place. Justice Horsey generalized application of *Revlon* to a much narrower setting than the Chancellor ever had. "[T]here are, generally speaking and without excluding other possibilities, two circumstances which may implicate [*Revlon*] duties."[301] First, a company may sell itself or break itself up. Second, a company, in response to a takeover bid, may abandon its business strategy and undertake a transaction that involves the company's break up. *Revlon* does not apply if the defensive action is "not an abandonment of the corporation's continued existence."[302] The Chancellor's *Revlon* analysis was "correct as a matter of law," said Justice Horsey. "However, we premise our rejection of plaintiffs' *Revlon* claim on different grounds, namely," that the dissolution or break up of Time was not inevitable.[303]

Justice Horsey followed the Chancellor more closely in the *Unocal* analysis. Where Chancellor Allen had given the Delaware Supreme Court an extremely deferential interpretation of *Unocal*, daring the court to revivify the standards, Justice Horsey unquestioningly accepted the Chancellor's approach and in fact relaxed *Unocal* even more. Although Justice Horsey was not as explicit as Chancellor Allen in holding that any bid was a threat because it challenged the target's business plan, he provided examples just as fatuous. Just as Vice-Chancellor Berger did in *Polaroid II*, Justice Horsey focused on the potential for target shareholder confusion as the genesis for *Unocal* threats. Shareholders might be confused about the merits of the unwanted bid versus the target's business plan. They might also be confused by conditions attached by the bidder to its bid and by bidder's timing, which might even have been designed to confuse and thwart a shareholder vote.[304] Understand, the board need not actually have any facts upon which to base such a finding. It seems to be enough that a board could reasonably conclude such things. Obviously, any board could make at least the first two conclusions about any unwanted bid.

As though these harms were not sufficient to permit any board to find a threat in any setting, Justice Horsey discussed, admittedly

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[301] *Time II*, 571 A.2d at 1150.
[302] *Id.*
[303] *Id.*
[304] *Id.* at 1153.

obliquely, the central economic question about takeover bids: Given conditions of uncertainty, is the bidder's bid higher than the target board's plan? Justice Horsey specifically rejected, by name, the Court of Chancery statements that said that a *Unocal* threat can only come from inadequate value or coercive structure.[305] Next, he held that *Unocal* does not even require a target board or the court to determine, let alone compare, the present value of either the bid or the target's own alternative or preexisting plan. In other words, the target board is not required to make the fundamental economic inquiry. Nonetheless, a target board can find a threat under *Unocal* if it can conclude that the *future* value of its own plan will likely be higher than the *current* value of the bid![306] Obviously, given time enough, the future nominal value of one strategy can plausibly be believed to exceed the present value of any other strategy.

Justice Horsey thought he was upholding a genuine proportionality test in *Time II*.[307] In fact, though, the consequence of his analysis was the same as that of Chancellor Allen: if the target can frame its action as congruent with its preexisting business strategy, it can preclude shareholders from accepting an unsolicited bid. Justice Horsey said Time's action was proportionate because it "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."[308] The notion that cramming down is different from carrying forward in this context is totally risible because they both mean the board can prevent shareholders from accepting any alternative. The

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[305]*Time II*, 571 A.2d at 1152-53 (citing Grand Metro. PLC v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); City Capital Assocs. Ltd. Partnership v. Interco Inc., 551 A.2d 787 (Del. Ch.), *appeal dismissed*, 566 A.2d 1070 (Del. 1988); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986)).

[306]*See id.* at 1149, 1153. Justice Horsey related that when the Time board evaluated Paramount's increase in its *current* offer to $200 it found the bid still inadequate because the Time-Warner combination "offered a greater long-term value." *Id.* at 1149. In other words, at some undefined point in the future, Time-Warner would likely be worth more per share than $200. Well, yet, I think that is right. The rub, of course, can be phrased in two ways: At the point Time-Warner is worth more than $200, what will be the value of the $200 paid long ago and invested ever since? Alternatively, one could ask: What is the value, today, of Time-Warner and is it more or less than $200? The Time board made no attempt to reduce the value of Time-Warner to present value. Justice Horsey implied that Time's conclusion that at some point Time would be worth more than $200 allowed it to find the Paramount bid a threat: "In this case, the Time board reasonably determined that inadequate value was not the only legally cognizable threat . . . ." *Id.* at 1153.

[307]*Id.* at 1154 n.18 (rejecting commentators' argument that once a threat has been found the proportionality inquiry is illusory).

[308]*Id.* at 1154-55.

true distinction in Justice Horsey's logic is not between cramming down and carrying forward but between pre-existing plans and reactive alternatives. As long as the board can point to some pre-existing policy (presumably such as "going our own way independently with the superb management we're fortunate to have"), it can carry that forward, even by means of a transaction in an "altered form."[309] *Unocal* was dead. The business judgment rule prevailed.

VI.

So it was that *Unocal* was created, debated, and turned into the equivalent of the business judgment rule. And so ends the first part of the life and adventures of *Unocal*. For about four years the interpretation of *Unocal* in *Time II* held sway. But the conversation never entirely ended. A new Chief Justice, a controversial end to Justice Moore's tenure, and other developments changed *Unocal* dramatically. The story of those changes is in Part II of the *Life and Adventures of* Unocal.

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[309] *Time II*, 571 A.2d at 1155.