Comment

IVANHOE PARTNERS v. NEWMONT MINING CORP.—THE UNOCAL STANDARD: MORE BARK THAN BITE?

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I. INTRODUCTION

In the past two decades, battles for corporate control have increased in number as well as sophistication.¹ In the face of a hostile tender offer,² a target corporation's board of directors will often adopt

¹ See Austin, Nigem & Bernard, Tender Offer Update: 1987, Mergers & Acquisitions, July-Aug. 1987, at 49, 49-50 (recognizing an increase in tender offer activity in the early 1980s and the increasingly innovative tender offer defensive tactics).

² See H.R. REP. No. 1711, 90th Cong., 2d Sess. 1, reprinted in 1968 U.S. CODE CONG. & ADMIN. NEWS 2811, 2811. The term "tender offer" has been defined as "a bid by an individual or group to buy shares of a company—usually at a price above the current market price. Those accepting the offer are said to tender their stock for purchase. The person making the offer obligates himself to purchase all or a specified portion of the tendered shares if certain specified conditions are met." Id.
a defensive strategy aimed at defeating the takeover attempt and ensuring the corporation's continued independence. Much of the litigation arising in the takeover context challenges the defensive strategy employed as a breach of the fiduciary duties owed by a corporation's board of directors to the corporation and its shareholders. In deciding these cases, courts have attempted to accomplish the twin objectives of respecting the directors' authority to manage the business and affairs of the corporation, and of protecting shareholders' rights.

In most contexts, the decisions of a corporation's board of directors are insulated from judicial scrutiny, and the individual directors are shielded from personal liability, by the business judgment rule. Much of the protection afforded to directors by the rule results from its placement of the initial burden of proof on the party challenging the decision to establish facts that rebut the rule's favorable presumptions. In the takeover context, however, the Delaware Supreme Court has altered the application of the business judgment rule by shifting the initial burden of proof to the target directors. Under the rule established in *Unocal Corp. v. Mesa Petroleum Co.*, directors must show the reasonableness of their defensive responses before the protections of the rule will be conferred.

Initially, the *Unocal* decision was viewed by commentators as a severe restriction on the application of the business judgment rule.

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3. This litigation is typically in the form of a derivative action brought by the target corporation's shareholders or by the tender offeror. See Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984) (defining a derivative action as an "action developed in equity to enable shareholders to sue in the corporation's name where those in control of the company have refused to assert a claim belonging to it"). The remedy sought is usually monetary damages from directors for losses allegedly suffered by the corporation as a consequence of a completed transaction, or injunctive relief to enjoin the defensive actions taken by the target corporation.

4. See id. at 811 n.4. See also Comment, *Unocal Corp. v. Mesa Petroleum Co.*, 72 Va. L. Rev. 850, 851 n.3 (1986) (recognizing the view that successful defensive tactics appear to deny shareholders an opportunity to sell their stock at a premium, since the price offered by a tender offeror is generally higher than the market price of the stock). See also Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 254 (7th Cir. 1986), rev'd, 107 S. Ct. 1637 (1987) ("It is supposed to be the shareholders' company, for it is they who are entitled to all the income that the company generates after paying off all contractually or otherwise obligated expenses.").

5. Aronson, 473 A.2d at 812 (discussed infra notes 51-72 and accompanying text).

6. See id.

7. 493 A.2d 946 (Del. 1985).

8. See id.
in the takeover context. In placing the initial burden of proof on directors to show the reasonableness of their actions in the face of a hostile tender offer, the Unocal court seemingly removed much of the protection afforded to directors by the rule.

However, subsequent application of the Unocal standard indicates that while the Delaware Supreme Court may have altered its standard for reviewing directors' actions in response to takeover attempts, the alteration detracts little, if any, from the protections of the business judgment rule. Very few Delaware Supreme Court cases applying the Unocal standard have found a board's adoption of defensive tactics to be unprotected by the rule, leading one to question just how far a board of directors can go in defending against a takeover attempt before losing the protections of the business judgment rule. The Delaware Supreme Court decision, Ivanhoe Partners v. Newmont Mining Corp., seems to answer that a board of a Delaware corporation can go quite far in implementing a strong arsenal of defensive

9. See Veasey, The New Incarnation of the Business Judgment Rule in Takeover Defenses, 11 Del. J. Corp. L. 503, 512 (1986) (stating that courts applying Delaware law will subject directors' defensive decisions to stricter scrutiny). See also Pease, Outside Directors: Their Importance to the Corporation and Protection From Liability, 12 Del. J. Corp. L. 25, 70 (1987) (referring to the Unocal decision, this commentator states: "Certainly one can question whether the Delaware Supreme Court has effectively abandoned the business judgment rule as to antitakeover measures even though it continues to speak of its applicability.").

10. See Johnson & Siegel, Corporate Mergers: Redefining the Role of Target Directors, 136 U. Pa. L. Rev. 315, 338 (1987). These commentators refer to the Unocal standard as superficial, and one that is easily met by defendant directors. Id. "While professing concern over the directors' conflict of interest, the court in Unocal constructed a toothless standard for testing whether directors have fulfilled their duty of loyalty." Id. at 330.

11. See Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985) (applying the business judgment rule to a board's adoption of a defensive poison pill); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) (upholding a board's adoption of a selective stock repurchase in response to a hostile tender offer under the business judgment rule); Polk v. Good, 507 A.2d 531 (Del. 1986) (applying the business judgment rule to a board's repurchase of a threatening shareholder's stock at a premium); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987) (upholding a board's declaration of a dividend facilitating a "street sweep" by the target corporation's largest shareholder, under the business judgment rule). But see Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986) (holding that a board's defensive measure was not protected by the business judgment rule where it was implemented after the break-up of the corporation was inevitable).

tactics without removing itself from the protective custody of the business judgment rule.\textsuperscript{13}

\textit{Ivanhoe} involved a challenge to a three-pronged defensive strategy implemented by a target board of directors in response to a takeover attempt.\textsuperscript{14} The target was Newmont Mining Corporation, and the raider was T. Boone Pickens, Jr. Mr. Pickens initiated the takeover battle through his Ivanhoe Acquisition Corporation (Ivanhoe) with a two-tier tender offer\textsuperscript{15} for forty-two percent of Newmont at $105 per share.\textsuperscript{16} In defense, the Newmont Board of Directors amended a standstill agreement with Newmont's largest shareholder, Consolidated Gold Fields, and declared a large dividend which enabled Gold Fields to conduct a "street sweep"\textsuperscript{17} of Newmont shares, thereby increasing its ownership to 49.7%.\textsuperscript{18} These measures effectively defeated Ivanhoe's offer.\textsuperscript{19}

Ivanhoe sought to enjoin the Newmont directors' defensive measures in the Delaware Court of Chancery, claiming the directors breached the fiduciary duties owed to Newmont shareholders.\textsuperscript{20} The court of chancery denied Ivanhoe's motion for a preliminary injunction.\textsuperscript{21} The Delaware Supreme Court accepted the expedited interlocutory appeal and confronted the issue of whether the Newmont Board's defensive strategy was protected by the business judgment rule.\textsuperscript{22}

Applying the \textit{Unocal} two-pronged standard, the supreme court found that the board satisfied both prongs of its initial burden.\textsuperscript{23} Therefore, the court held that the business judgment rule protected

\begin{itemize}
\item \footnotesize 13. See Franklin, "Reasonable" Revisited: Effect of Newmont on Takeover Defenses Debated, 198 N.Y.L.J. 5, col. 2 (1987). Referring to \textit{Ivanhoe}, this author observes: "Last month's decision is seen as a wide reaffirmation of directors moving under the protection of the business judgment rule . . . to prevent an unwanted takeover." \textit{Id.}
\item \footnotesize 14. \textit{Ivanhoe}, 535 A.2d at 1337.
\item \footnotesize 15. \textit{See infra} note 144 (defining the term "two-tier tender offer").
\item \footnotesize 16. \textit{Ivanhoe}, 535 A.2d at 1339. The remaining shares were to be acquired in a second-step transaction, to which Ivanhoe made no firm commitment, and which remained contingent upon obtaining financing. \textit{Id.}
\item \footnotesize 17. \textit{See infra} note 101 (defining "street sweep").
\item \footnotesize 18. \textit{Ivanhoe}, 535 A.2d at 1337.
\item \footnotesize 19. \textit{Id.}
\item \footnotesize 20. \textit{Id.}
\item \footnotesize 22. \textit{Ivanhoe}, 535 A.2d at 1336, 1341.
\item \footnotesize 23. \textit{Id.} at 1342-44.
\end{itemize}
the board's tripartite defensive measure.\textsuperscript{24} Since Ivanhoe was unable to show that the directors were primarily motivated by entrenchment concerns or some other breach of fiduciary duty, the court refused to substitute its judgment for that of the board, and affirmed the court of chancery's denial of Ivanhoe's motion for a preliminary injunction.\textsuperscript{25}

Ivanhoe is a significant decision in Delaware corporate law. This decision added a board's facilitation of a "street sweep" to the arsenal of defensive antitakeover measures protectable under the business judgment rule. More importantly, this case indicates that the \textit{Unocal} two-pronged standard is not a difficult burden to satisfy and posits that, under the second prong, what the Delaware Supreme Court considers "reasonable in relation to the threat posed"\textsuperscript{26} encompasses a great deal.\textsuperscript{27}

This comment will trace the development of the business judgment rule in Delaware and discuss its application by the Delaware Supreme Court in the takeover context. Specifically, the application of the business judgment rule in \textit{Ivanhoe Partners v. Newmont Mining Corp.} will be addressed, as will the significance of this decision in Delaware corporate law.\textsuperscript{28}

II. Background

A. Development of the Business Judgment Rule in Delaware

The business judgment rule is a common law principle of corporate law that originated over 150 years ago.\textsuperscript{29} It has held a preeminent position in Delaware corporate law for many years.\textsuperscript{30} Despite its history, the business judgment rule has yet to be codified in

\textsuperscript{24} Id. at 1345.
\textsuperscript{25} Id. at 1345-46.
\textsuperscript{26} \textit{Unocal}, 493 A.2d at 955.
\textsuperscript{27} See Franklin, supra note 13, at 5, col. 2 (presenting a similar proposition).
\textsuperscript{28} The procedural issues involved in this decision are not within the scope of this comment.
\textsuperscript{29} Arsht, \textit{The Business Judgment Rule Revisited}, 8 Hofstra L. Rev. 93, 93 (1979). This article provides an excellent discussion of the business judgment rule's origins and its earliest applications in cases involving the liability of bank directors. \textit{Id.} at 97-100.
\textsuperscript{30} See Bodell v. General Gas & Electric Corp., 140 A. 264, 267 (Del. 1927) (for an early application of the business judgment rule in Delaware).
Delaware. Some commentators argue that the rule is best left uncodified and suggest that a case-by-case approach allows the rule to be applied flexibly in response to the changing nature of corporate transactions. Others are of the opinion that codification is necessary

31. In fact, Pennsylvania is the only state known to this commentator to have codified the business judgment rule. See 15 Pa. Cons. Stat. Ann. § 1721(d) (Purdon 1989).

It is important to distinguish between standards of conduct for directors, which have been codified in many states, and the business judgment rule. See Moran v. Household Int’l, Inc., 490 A.2d 1059, 1076 (Del. Ch.), aff’d, 500 A.2d 1346 (Del. 1985) (noting that the business judgment rule is primarily a tool of judicial review and only indirectly a standard of conduct), aff’d, 500 A.2d 1346 (Del. 1985). See also Arsht, supra note 29, at 96 n.13 (noting how the business judgment rule operates only to protect directors if their challenged conduct satisfies the applicable standards of both loyalty and care, whether those standards are imposed by statute, or by common law through the limitations on the availability of the business judgment rule as a defense). Although the business judgment rule itself is not a standard of conduct, it does establish a standard of conduct indirectly through the limitations on its availability as a defense. Id. at 96. These limitations and the standard of conduct they impose will be discussed in greater depth later in this comment.

The Committee on Corporate Laws recognizes the distinction in the Official Comment to § 8.30, which defines the general standard of conduct for directors, by expressly stating: “[S]ection 8.30 does not try to codify the business judgment rule or to delineate the differences, if any, between that rule and the standards of director conduct set forth in this section.” REvISED MODEL BUSINESS CORP. ACT § 8.30, Official Comment (1984) [hereinafter RMBCA].

32. See Veasey, New Insights Into Judicial Deference to Directors’ Business Decisions: Should We Trust the Courts?, 39 Bus. Law. 1461, 1463 (1983) (discussing the debate over codification of the business judgment rule and how it could create more problems than it attempts to solve).

See also Veasey & Seitz, The Business Judgment Rule in the Revised Model Act, the Trans Union Case, and the ALI Project—A Strange Forrider, 63 Tex. L. Rev. 1483, 1483 (1985) (stating that the business judgment rule lacks the clarity and consensus required for codification). See also RMBCA, supra note 31, § 8.30, Official Comment (“The elements of the business judgment rule and the circumstances for its application are continuing to be developed by the courts. In view of that continuing judicial development, section 8.30 does not try to codify the business judgment rule . . . ”).

The American Law Institute (ALI) did not have the same problem articulating a definition of the business judgment rule, and has stated its recommendation as follows:

(c) A director or officer who makes a business judgment in good faith fulfills his duty under this Section if:

(1) he is not interested in the subject of his business judgment;
(2) he is informed with respect to the subject of his business judgment to the extent he reasonably believes to be appropriate under the circumstances; and
(3) he rationally believes that his business judgment is in the best interests of the corporation.
in order to clarify the rule and protect against inconsistent results in its application. Notwithstanding the debate, it is unlikely that the business judgment rule will be codified in Delaware any time in the near future.

Although the business judgment rule has not been codified, it is not without a statutory basis. Section 141(a) of the General Corporation Law of Delaware states that "[t]he business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors . . . ." This provision recognizes that the directors, not the shareholders, have the power and the duty to control and manage the business of the corporation. The board in exercising its authority must act in accordance with its fiduciary duties of care and

(d) A person challenging the conduct of a director or officer under this section has the burden of proving a breach of due care (and the inapplicability of the provisions as to the fulfillment of duty under subsection (b) or (c), and the burden of proving that the breach was the legal cause of damage suffered by the corporation.

ALI, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01 (Tent. Draft No. 4, 1985) [hereinafter ALI].

33. See Veasey, supra note 32, at 1463 (discussing, although not supporting, the view that codification of the rule would protect directors from liability imposed by a judge who fails to understand the state of the decisional law).


35. See Aronson, 473 A.2d at 811 ("A cardinal precept of the General Corporation Law of . . . Delaware is that directors, rather than shareholders, manage the business and affairs of the corporation.").

36. Concerning the duty of care, the ALI has stated its recommendation as follows:

(a) A director or officer has a duty to his corporation to perform his functions in good faith, in a manner that he reasonably believes to be in the best interest of the corporation, and with the care that an ordinarily prudent person would reasonably be expected to exercise in a like position and under similar circumstances.

(1) This duty includes the obligation to make or cause to be made, such inquiry as the director or officer reasonably believes to be appropriate under the circumstances.

(2) In performing any of his functions (including his oversight functions), a director or officer is entitled to rely on materials and persons in accordance with §§ 4.02-.03.

(b) Except as otherwise provided by statute or by a standard of the corporation and subject to the board's ultimate responsibility for oversight, in performing its functions (including oversight functions), the board may delegate, formally or informally by course of conduct, any function . . . to committees of the board or to directors, officers, employees, experts, or other persons; a director may rely on such committees and persons in fulfilling his duty under this Section with respect to any delegated function if his reliance is in accordance with §§ 4.02-.03.
loyalty.\textsuperscript{37} Exactly what constitutes duty of care, and what constitutes duty of loyalty, is the subject of a great deal of commentary and debate.\textsuperscript{38}

\begin{footnotesize}
ALI, \textit{supra} note 32, § 4.01. Cf. RMBCA, \textit{supra} note 31, § 8.30 (for a similar statement of the general standard of conduct for directors).

\textsuperscript{37} See Guth v. Loft, Inc., 23 Del. Ch. 255, 270, 5 A.2d 503, 510 (1939) ("While technically not trustees, [corporate officers and directors] stand in a fiduciary relation to the corporation and its stockholders"). This case is well-known for its articulation of the duty of loyalty: "Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests . . . . The rule that requires an undivided and unselfish loyalty to the corporation demands that there be no conflict between duty and self-interest." \textit{Id.} \textit{See also} Comment, \textit{Statutory Limitations on Directors' Liability in Delaware: A New Look at Conflicts of Interest and the Business Judgment Rule}, 24 \textit{Harv. J. on Legis.} 527, 536-37 (1987). This commentator discusses the evolution of the duty of loyalty, and how courts initially imposed a per se rule against self-interested transactions under which directors were not permitted to engage in transactions involving conflicts of interest. \textit{Id.} This rule was later abandoned in favor of a fairness standard upon the recognition that some self-interested transactions between directors and the corporation could nonetheless benefit the corporation. \textit{Id.}

Under § 144(a) of the General Corporation Law of Delaware, if directors are shown to have an interest in the challenged transaction, other than one accruing to shareholders generally, they must show that the transaction is fair as to the corporation and shareholders. Del. Code Ann. tit. 8, § 144 (1983). Hence, the business judgment rule will not apply if director self-interest is shown. This is significant in the takeover context, since a board's adoption of defensive measures in response to a tender offer will often benefit directors by securing their continued control, arguably constituting a conflict of interest and implicating the duty of loyalty. Nevertheless, the Delaware Supreme Court has refused to hold that defensive tactics automatically implicate the duty of loyalty and the fairness standard. \textit{See} Unocal Corp. \textit{v.} Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) (discussed \textit{supra} text accompanying notes 77-95).

\textsuperscript{38} In the takeover context, Delaware courts have not clearly defined the boundaries of these separate duties, and the distinction between the two remains nebulous. \textit{See} Comment, \textit{supra} note 37, at 543. Courts finding that a particular defensive measure breached a fiduciary duty have not always articulated which fiduciary duty—duty of care or duty of loyalty—has been breached, or have referred almost interchangeably to the two duties. \textit{See}, e.g., Revlon, Inc. \textit{v.} MacAndrews & Forbes Holdings, 506 A.2d 173, 185 (Del. 1986) (holding directors' defensive actions, after a sale of the corporation was inevitable, constituted a breach of the directors' duty of care). In \textit{Revlon}, although the Delaware Supreme Court ultimately found the directors' conduct constituted a breach of their duty of care, \textit{id.}, the court, earlier in its opinion, confusingly referred to the directors' conduct as a breach of their duty of loyalty. \textit{Id.} at 182 ("[W]hen the Revlon board entered into an auction-ending lock-up agreement . . . on the basis of impermissible considerations . . . the directors breached their primary duty of loyalty."). Quite clearly, the directors' conduct in this case indicates a breach of their duty of loyalty, since the directors acted primarily in their own personal interests, to avoid potential personal liability, in granting a lock-up option to one who would relieve the directors
\end{footnotesize}
The business judgment rule was derived from a judicially recognized need to protect directors who have exercised their statutory authority to manage the business of the corporation in accordance with their fiduciary obligations. As usually applied, it means that courts will not interfere with the business decisions of directors, or impose liability on directors, for honest mistakes of business judgment.

There are several rationales underlying the business judgment rule. First, the rule reflects judicial acknowledgement that courts are

of this potential liability. Id. at 184. But see Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1284 n.34 (Del. 1986) (no ambiguity exists as to which duty was breached, Ivanhoe makes it abundantly clear both duties were breached in Revlon). One reason why courts may use a duty of care analysis in cases where duties of loyalty are implicated, is the evidentiary difficulties involved in a duty of loyalty analysis. See Comment, supra note 37, at 552. Where the duty of loyalty is implicated, but the plaintiff runs into evidentiary difficulties, the court can proceed with a duty of care analysis. Id.

In light of the 1986 adoption of § 102(b)(7) to the DGCL, it is now extremely important for a court to articulate which fiduciary duty has been breached. See Del. Code Ann. tit. 8, § 102(b)(7) (1983 & Supp. 1986). This is so because § 102(b)(7) permits a corporation to include a provision in its certificate of incorporation which eliminates directors’ liability for breach of the fiduciary duty of care, while it does not permit a limitation of liability for any breach of the duty of loyalty, or for acts not in good faith. See generally Comment, supra note 37, at 528 (for a full discussion of this point and the implications of § 102(b)(7)). It is this commentator’s opinion that § 102(b)(7) will rarely serve to limit directors’ liability where a breach of fiduciary duty has been found in a board’s adoption of a defensive measure, since the duty of loyalty is usually implicated in such cases, and the courts can easily frame their reasoning to support a finding of breach of the duty of loyalty. Also, litigants challenging defensive measures as a breach of fiduciary duty will likely be careful to state specific allegations of a breach of the duty of loyalty in their complaints.

39. See Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (“The business judgment rule is an acknowledgement of the managerial prerogatives of Delaware directors under Section 141(a).”). Id. See also Comment, supra note 4, at 855 n.24 (signifying that in Aronson the Delaware Supreme Court recognized “the close link between the judicially-created business judgment rule and the broad discretion conferred on management by section 141(a) . . .”).

40. It is important to note that a distinction is often made between the business judgment rule and the business judgment doctrine. The rule is applied to shield directors from personal liability resulting from decisions, whereas the doctrine is applied to protect the decision itself, i.e., from being enjoined or set aside. See Hinsey, Business Judgment and the American Law Institute’s Corporate Governance Project: The Rule, the Doctrine, and the Reality, 52 GEO. WASH. L. REV. 609, 611-12 (1984) (discussing this distinction). But see Revlon, 506 A.2d at 180 n.10 (recognizing that Delaware decisions have not observed a distinction between the rule and the doctrine in transactional justification cases). This comment will use the term business judgment rule to connote both the rule and the doctrine.
ill-equipped to analyze business decisions and substitute their own business judgment for that of directors. Second, the rule recognizes that directors must be given room to take risks in order for the corporation to make a profit and should not be exposed to liability simply because the risks taken later prove to be unfruitful. Third, the rule embodies the simple recognition that nobody is perfect, including directors. Directors are not infallible, and they cannot always please every stockholder. Therefore, directors who have acted in good faith and in accordance with their fiduciary duties of care and loyalty should not be held liable for decisions which turn out poorly or to the displeasure of stockholders. Finally, the rule con-

41. See Beard v. Elster, 39 Del. Ch. 153, 165, 160 A.2d 731, 738-39 (1960) ("[W]e are precluded from substituting our uninformed opinion for that of experienced business managers of a corporation who have no personal interest in the outcome and whose sole interest is the furtherance of the corporate enterprise"). This rationale is premised on the simple recognition that directors who are familiar with the business of their corporation, who have experience in the business world, and who must often make decisions in the heat of the moment, are in a better position to make corporate business decisions than is a judge, who at best can attempt to exercise 20-20 hindsight. As it is noted in the Official Comment to § 8.30 of the RMBCA: "[T]he courts recognize that boards of directors . . . continuously make decisions that involve the balancing of risks and benefits for the enterprise. . . .[T] is unreasonable to reexamine these decisions with the benefit of hindsight." RMBCA, supra note 31, § 8.30, Official Comment.

Business and judicial economy concerns are also embodied in this rationale. If every business decision was subjected to judicial review at the request of a stockholder, corporate business would stagnate and the courts would be physically ill-equipped to handle such a large amount of litigation. See generally Arsh, supra note 29, at 95 (discussing the premises underlying the business judgment rule and the need to foster business and judicial economy).

42. The Committee on Corporate Laws articulated a similar rationale in adopting the "ordinary prudent person" standard rather than an "ordinary prudent businessman" standard in § 8.30, noting that "[t]he phrase recognizes the need for innovation, essential to profit orientation, and focuses on the basic director attributes of common sense, practical wisdom, and informed judgment." RMBCA, supra note 31, § 8.30, Official Comment. Directors must be given sufficient latitude to develop corporate policies and strategies if the corporation is to compete effectively in the marketplace. Hence, when directors' decisions are challenged, the court should limit its review to the decision-making process to see if the directors have fulfilled their duties of care and loyalty, and once these findings have been made, the court should not proceed to examine the substance of the directors’ decisions. Otherwise, directors would not pursue desirable business risks out of fear that their decisions could be second-guessed by the courts, even though they have fulfilled their fiduciary obligations in the decision-making process.

43. See Arsh, supra note 29, at 95 (noting that this rationale is simply a recognition of human nature).

44. This rationale for the business judgment rule recognizes that shareholders
siders the economic rationale that courts should not interfere with directors' decisions, nor impose liability on directors, because market forces already provide a sufficient monitor of director efficiency.45

Although the business judgment rule has been applied by Delaware courts for many years in many different contexts, and a plethora of legal commentary exists discussing the rule, its history reveals confusion and misunderstanding among the courts and commentators.46 This confusion is exemplified by criticisms that the business judgment rule acts as an absolute bar against judicial scrutiny of directors' decisions47 and imposes a very low standard of directorial conduct—serving as an "impenetrable shield to liability."48 One

who elect the directors cannot expect them to guarantee their decisions. A related concern is that few people would serve as directors if they could be held liable for decisions that turn out poorly even though they were made in good faith. See Arsh, supra note 29, at 97 ("The business judgment rule grew principally from the judicial concern that persons of reason, intellect, and integrity would not serve as directors if the law exacted from them a degree of prescience not possessed by people of ordinary knowledge.").

45. See Comment, supra note 37, at 534-35 ("Not only do businessmen know more about business than judges do, but competition in the product and labor markets and in the market for corporate control provides sufficient punishment for businessmen who commit more than their share of business mistakes." (quoting Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250 (7th Cir. 1986)). See generally Note, Corporate Auctions and Fiduciary Duties, 87 Mich. L. Rev. 276, 281 (1988) (discussing an economic rationale for the business judgment rule, and how the market forces demand efficiency in corporate management and operate as a check on board power).

46. See generally Arsh, supra note 29, at 93-101 (for an excellent discussion of the causes of, and confusion surrounding, the business judgment rule).

47. See id. at 100. As this noted commentator recognizes, the business judgment rule is not a defense that, once asserted, precludes judicial inquiry into the decision-making process followed by the directors in making the challenged decision. Rather, it serves as a "starting point for inquiry into the directors' decision-making process." Id. See also Johnson & Siegel, supra note 10, at 324 n.29 (noting that in applying the business judgment rule, courts have sometimes confused the decision-making process, which is reviewable, with the ultimate decision, which is not reviewable).

48. Arsh, supra note 29, at 100. This commentator notes that the plaintiff does not have to prove gross and palpable overreaching by directors in every context before the court will intervene. Id. at 110. This commentator also articulated an oft-quoted definition of the business judgment rule:

A corporate transaction that involves no self-dealing by, or other personal interest of, the directors who authorized the transaction will not be enjoined or set aside for the directors' failure to satisfy the standards that govern a directors' performance of his or her duties, and directors who authorized the transaction will not be held personally liable for resultant damages, unless:
noted commentator attributes the confusion to "the general failure to distinguish the business judgment rule from the presumptions and limitations that surround the rule's application and from the tendency of courts to use loose language in expressing the rule." 49 Irrespective of the causes, for many years Delaware courts did not provide a concise or complete definition of the business judgment rule. 50

B. From Confusion to Clarity—Aronson v. Lewis

The Delaware Supreme Court in Aronson v. Lewis 51 finally articulated a concise statement of both the elements and the limitations of the business judgment rule. The Aronson court defined the business judgment rule as follows:

It is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgment will be respected by the courts. The burden is on the party challenging the decision to establish facts rebutting the presumption. 52

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(1) the directors did not exercise due care to ascertain the relevant and available facts before voting to authorize the transaction; or
(2) the directors voted to authorize the transaction even though they did not reasonably believe or could not have reasonably believed the transaction to be for the best interest of the corporation; or
(3) in some other way the directors' authorization of the transaction was not in good faith.

Id. at 111-12.

49. Id. at 93-94 (footnote omitted).
52. Id. at 812 (citations omitted). Aronson deals with the business judgment rule in the context of a shareholder derivative action, where the plaintiff-shareholder has failed to make a demand on the board to bring suit—an application of the rule that is not within the scope of this comment. However, this application illustrates the distinction that has been made between the offensive and defensive use of the business judgment rule. The rule can be used offensively to cause dismissal of a derivative action by asserting that the decision of a disinterested litigation committee (appointed by the defendant directors) to dismiss the action, is a decision protected by the business judgment rule. (This is also referred to as the procedural use of the rule.)

The rule can also be used defensively, i.e., as a defense to the merits of the suit, in order to shield directors from liability and protect their decision from judicial
The court, in *Aronson*, also articulated three limitations on the application of the business judgment rule. The rule will not apply if: (1) director interest is present and the challenged transaction was not approved by a majority of disinterested directors;\(^\text{53}\) (2) the directors have not informed themselves of all material information reasonably available to them;\(^\text{54}\) or (3) the directors abused their discretion.\(^\text{55}\)

scrutiny. (This is also referred to as the substantive use of the rule.) See Morris & Henry, *The Aftermath of Zapata Corp. v. Maldonado: What is Left of the Business Judgment Rule?*, 88 Dick. L. Rev. 411, 412 (1984) (discussing the offensive and defensive uses of the business judgment rule). Arguably, the rule is used defensively even in the derivative action context since it is invoked as a defense to the plaintiff's allegations of director interest and demand futility. See *Aronson*, 473 A.2d at 809. Also, in determining demand futility, *Aronson* requires that a court look into the substantive nature of the challenged transaction. *Id.* at 814.

Irrespective of the distinction, in the takeover context, when a defensive strategy adopted by directors in response to a hostile tender offer is challenged, the business judgment rule is usually invoked by the directors solely as a defense to the merits of the suit, and operates substantively in this context to protect the directors' decision from scrutiny, and to protect the directors from personal liability if the rule's requirements have been met.

53. *Aronson*, 473 A.2d at 812. The court stated that this limitation applies where directors lack independence due to the control or domination of another, *id.* at 814, appear on both sides of a transaction, or where directors expect to derive a personal financial benefit from a transaction that does not devolve upon the corporation or all stockholders generally. *Id.* at 812 (citing Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)). In other words, the business judgment rule will not apply if the directors violated their duty of loyalty. See generally supra note 37 and accompanying text (discussing corporate director's duty of loyalty). *Sinclair Oil* indicates that where director self-interest or self-dealing is shown, and thereby a breach of duty of loyalty, the business judgment rule does not apply. Rather, the intrinsic fairness test will apply, and the burden of proof shifts to the defendant directors to prove that the transaction was entirely fair. *Id.* See infra note 66 (discussing *Sinclair Oil* in greater depth).

This limitation is of particular significance in the takeover context because of the likelihood that target directors acted in their own self-interest in approving defensive measures in order to retain control. Delaware courts will still apply the business judgment rule in such situations, although not in its traditional form. See *Unocal*, 493 A.2d at 954-55. This will be discussed in greater depth later in this comment. See infra text accompanying notes 77-95.

54. *Aronson*, 473 A.2d at 812. This limitation requires the directors not only to arm themselves with all material information reasonably available to them, but also to act in accordance with the applicable standard of care once they are so armed. *Id.* The *Aronson* court definitively stated that the standard by which director liability is to be judged under the business judgment rule is gross negligence. *Id.* In other words, the business judgment rule will not apply if the directors violated their duty of care, i.e., they were grossly negligent in performing their duties.

55. *Id.* As one noted commentator states:

This particular limitation to the business judgment rule is, perhaps, not a limitation at all, but simply an application of the fundamental principal
The court stated one other limitation which, at first blush, appears to be a self-evident requirement of the rule: that the business judgment rule does not apply to corporate decision making until after a decision has been made. In application, this limitation can have serious implications because it is not always clear whether a decision has been made by directors. While the business judgment rule will apply to a conscious decision to refrain from acting, it will not be applied where directors have failed to act without first making a conscious decision not to act. Hence, in cases where director

behind the rule. An honest error in judgment is allowed. But a judgment that cannot be sustained on some rational basis falls outside the protection of the business judgment rule... Arsh, supra note 29, at 122. Hence, even though a disinterested board has made a good-faith and informed decision, the business judgment rule will not apply to protect the directors' decision, or shield the directors from liability, where the challenged transaction constitutes an abuse of discretion. As Mr. Arsh notes, this limitation often arises in the context of a merger, or the sale or purchase of corporate assets, and if the value determined by the directors falls within a range of values in which reasonable people could differ in opinion, then most courts will not interfere with the directors' business judgment. Id. at 122-23. However, a court will interfere with the decision if it finds that the directors' decision was "arbitrary, resulted from a reckless disregard of the corporation's... best interests, or was simply so far removed from the realm of reason that it cannot be sustained." Id.

This limitation also illustrates how the business judgment rule does not preclude judicial inquiry into a board's decision-making process, but only into the substance of the decision itself. Hence, while courts and commentators refer to the rule as "insulating" a board's decision from judicial scrutiny, such terminology usually only refers to the deferential manner in which a court will examine a board's decision when the business judgment rule applies. The determination of whether a board abused its discretion seems to require judicial inquiry into the substance of the board's decision before the business judgment rule is shown to be inapplicable, since it requires an analysis of the reasonableness of the board's decision. However, in conducting its reasonableness analysis, the court does not put itself in the board's position to see if it would have made the same decision. Rather, the court only determines whether there was some reasonable basis for the directors' decision, looking at the methodologies and procedures employed by the board in making its decision. See id. at 126-27. The court will only inquire into the circumstances of the challenged transaction to the extent necessary to determine whether the directors' decision was an exercise of reasoned judgment, or a reckless decision. Id. at 125. For example, where a board's sale of corporate assets is challenged, the court might look at the range of values that financial advisors provided to the board, and determine if there was any rational basis for the board to accept a lower price. See Pease, supra note 50, at 62.

56. Aronson, 473 A.2d at 813 (citing Zapata Corp. v. Maldonado, 430 A.2d 780, 782 (Del. 1980)).

57. Id. For an excellent illustration of a situation where it would be difficult to determine whether there has been a conscious decision to refrain from acting by a board of directors, see Pease, supra note 50, at 78. This commentator notes
inaction is challenged as improper and such inaction is not the product of a conscious decision not to act, the directors will not be able to claim the protection of the business judgment rule. Rather, their inaction or omission will be examined under the applicable standard of care. 58

In Aronson, the Delaware Supreme Court applied what has been termed the traditional business judgment rule. 59 In its traditional

that much of what directors engage in does not involve board action. Id. at 76. Hence, this limitation on the business judgment rule could have serious effect on directors if they are unable to show that their inaction was the result of a conscious decision not to act. It is clear that the Aronson court did not believe that mere notice to directors of a situation, followed by director inaction regarding the situation, alone would be sufficient to show a conscious decision to refrain from acting, protected by the business judgment rule. See Aronson, 473 A.2d at 813 n.7 (citing with disapproval Graham v. Allis-Chambers Mfg. Co., 188 A.2d 125 (Del. 1963), where the business judgment rule was improperly applied according to the Aronson court).

58. See Pease, supra note 50, at 79 (discussing ALI, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (Tent. Draft No. 3, 1984)).

59. See Note, supra note 45, at 280-81 (noting that the traditional business judgment rule creates a presumption that disinterested directors have met all the required standards of conduct, and applies to operational decisions made by directors in the daily conduct of the corporation's affairs, such as decisions to purchase new capital assets or expand production capacity). An altered form of the business judgment rule applies where directors have adopted a defensive measure in response to a tender offer, and has been termed the "enhanced duty rule." Pease, supra note 9, at 70. See infra text accompanying notes 77-90 & infra note 79 (discussing this altered form of the business judgment rule).

The challenged transaction in Aronson was a board's approval of a generous employment agreement with a large stockholder-director. Aronson, 473 A.2d at 808-09. The business judgment rule was applied in the context of a derivative action, and the court confronted the issue of when demand will be excused as futile in determining whether to grant a motion to dismiss. Id. at 813. This application of the rule is not within the scope of this comment. However, Aronson significantly establishes that in order for a derivative action to survive motion to dismiss where no demand has been made on the board to bring suit, the shareholder-plaintiff's complaint must allege with particularized facts (creating a reasonable doubt) either: that a majority of the directors were not independent or disinterested in approving the challenged transaction, or that the business judgment rule will not otherwise apply to the challenged transaction, i.e., that the directors breached their fiduciary duties in some other way. Id. at 814-15. It is clear that a complaint containing mere conclusory statements that the directors lacked independence or disinterest will not meet this test. See, e.g., id. at 815 (plaintiff's complaint, which contained a mere conclusory statement that the directors were not independent because a major stockholder of the corporation selected them, was not sufficient to survive a motion to dismiss). See generally Pease, supra note 50 (for a more in-depth discussion and analysis of the Aronson decision); Terrell, Bricks for the Business Judgment Citadel—Recent Developments in Delaware Corporate Law, 9 Del. J. Corp. L. 329, 329-34 (1984) (discussing the impact of Aronson on Delaware corporate law).
form, the business judgment rule operates as a presumption, arising as soon as a board's decision is challenged, supra note 29, that the directors have fulfilled their fiduciary duties of care and loyalty. In other words, it is presumed that the requirements of the rule—good faith, due care, disinterestedness, and absence of abuse of discretion—have been met. The initial burden is on the plaintiff challenging the decision to overcome this presumption. In determining whether the plaintiff has met this burden, the court will examine the decision-making process employed by the directors without reviewing or second-guessing the decision itself. If the plaintiff is unable to show that the presumptions do not apply to the directors' decision, the court will not interfere with the decision or impose individual liability upon the directors. If the plaintiff is able to show self-dealing or personal

60. See Aronson, 473 A.2d at 812. See also Arsht, supra note 29, at 131 (signifying that the plaintiff triggers the presumption by showing that the defendants made some decision as directors).

61. In cases involving tender offer defensive tactics, the Delaware Supreme Court has recognized that it is inappropriate to presume that directors have fulfilled their duty of loyalty, because of the strong likelihood that a board may be acting primarily in its own interests in such situations. See Unocal, 493 A.2d at 954. Therefore, in such cases, the traditional business judgment rule is not applied, and the initial burden of proof rests with the defendant directors. See id. at 955.

62. See Arsht, supra note 29, at 112.

63. Aronson, 473 A.2d at 812. See also Arsht, supra note 29, at 130-33 (discussing the degree or quality of proof necessary to overcome the presumptions of the business judgment rule).

64. See supra note 55 (discussing the reviewability of the decision-making process vis-a-vis the nonreviewability of the decision itself).

65. One noted commentator concisely states the ways a plaintiff can meet his burden as follows:

The rule will not apply if the plaintiff can show that: (1) the directors (a) stood on both sides of the transaction, (b) had a personal financial interest not shared by the corporation and shareholders, or (c) lacked independence because of domination and control by a person or group, or (2) the directors (a) did not inform themselves, prior to making a business decision, of all material information reasonably available to them and (b) did not act with the requisite care in the discharge of their duties. Requisite care is predicated on the standard of "gross negligence."

Pease, supra note 50, at 71 (footnotes omitted). This statement illustrates how the plaintiff can meet his burden by showing that the directors breached either their duty of loyalty (subsection (1) above) or their duty of care (subsection (2) above).

66. See Sinclair Oil Co., 280 A.2d at 720. In Sinclair Oil, the plaintiff, a minority shareholder of a subsidiary corporation, challenged large dividend payments which the defendant-parent corporation caused its 97%-owned subsidiary to pay. Id. at 719. Before the Delaware Supreme Court would apply the intrinsic fairness test, the plaintiff had to show that the parent corporation caused "[t]he subsidiary to act in such a way that the parent receiv[ed a benefit] to the exclusion of, and
financial interest on the part of the directors who approved the challenged transaction, then the burden of proof will shift to the
detriment to, the minority stockholders of the subsidiary." Id. at 720. The plaintiff was unable to show self-dealing with respect to the dividend payments even though the defendant had received large sums of money from the distributions, because all shareholders had received their proportionate share of the dividends. Id. at 721-22. Therefore, the Delaware Supreme Court applied the business judgment rule and refused to interfere with the defendant's decision to pay the dividends, since the plaintiff failed to meet his burden of showing that the defendant had not complied with the business judgment rule. Id. at 722.

The Sinclair court did, however, apply the intrinsic fairness test to the defendant's act of causing its subsidiary to contract with defendant's wholly owned subsidiary. Id. at 723. Here the plaintiff was able to show self-dealing since the defendant had received a benefit (the products received under the contract) to the detriment of the minority shareholders (who did not share in the receipt of these products). The court then found the defendant liable for breach of contract since the defendant was unable to meet its burden of showing that causing its subsidiary not to enforce the contract was intrinsically fair to the minority shareholders. Id.

This case illustrates the benefits afforded to directors by the traditional business judgment rule's presumptions, and its placement of the initial burden of proof on the party challenging the transaction. Although the challenged dividend payments did not survive judicial scrutiny when (erroneously) reviewed by the chancery court under the intrinsic fairness test, with its burden on the defendant to show the dividend was entirely fair, they did survive when protected by the business judgment rule because the plaintiff was unable to overcome his burden of proving the inapplicability of the rule's presumptions. The court alluded that the rule would not have applied had the plaintiff been able to show an improper motive in the defendants causing the payment of the dividend. Id. at 722. Apparently the plaintiff's assertion, that the defendant's sole motive was its need for cash, was not alone sufficient to overcome the rule's presumption of good faith. It is quite possible that the court would not have applied the business judgment rule and would have invalidated the dividend payments, had the plaintiff produced better evidence to show bad faith, or to show that the defendant did not cause the dividend to be paid in the honest belief that it was in the best interest of the corporation, i.e., since the large distributions sent the corporation into near dissolution. See id. at 720-21. See also Weinberger v. UOP, Inc., 457 A.2d 701, 710-11 (Del. 1983) (applied the fairness test, requiring the defendant-directors who stood on both sides of the challenged transaction to show both fair price and fair dealing with respect to the cash-out merger which it approved and recommended to the shareholders).

67. See Aronson, 473 A.2d at 812; Del. Code Ann. tit. 8, § 144(a)(3) (1983) (providing that a transaction between a corporation and its directors or officers, or between a corporation and another organization in which the directors have a financial interest, is not void or voidable solely for this reason if the transaction is fair as to the corporation at the time it is approved by the board). See also Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964) (recognizing that the fact that certain board members are large stockholders does not show sufficient personal pecuniary interest to make the business judgment rule inapplicable); Arsh, supra note 29, at 116 (noting that not every personal interest on the part of directors will remove the protections of the business judgment rule; rather the director's interest must be the equivalent of self-dealing where the director receives a personal benefit not received by the corporation or all shareholders proportionately).
defendant-directors to prove that the transaction was intrinsically fair to the corporation. If the plaintiff is able to show that the directors did not act in good faith, on an informed basis, or in the honest belief that their actions were in the best interest of the corporation, the court will impose liability on the directors upon a finding that the directors were grossly negligent.68

The gross negligence standard adopted by the Aronson court is difficult to prove69 but is "less exacting than simple negligence."70 To some degree, this is why the definition and application of the business judgment rule in Aronson have been viewed as strengthening, as well as clarifying, the rule in Delaware.71 Whether the Aronson decision strengthened the business judgment rule, or merely articulated an existing but unclarified rule, this decision clearly illustrated that the business judgment rule affords directors a great deal of protection in Delaware.

68. See Smith v. Van Gorkom, 488 A.2d 858, 893 (Del. 1985) (holding that the defendant-directors' decision to approve a proposed cash-out merger was not protected by the business judgment rule because the directors were grossly negligent in failing to inform themselves adequately before approving the merger proposal); Aronson, 473 A.2d at 812 ("[U]nder the business judgment rule director liability is predicated upon concepts of gross negligence.").

69. See Arsht, supra note 29, at 131 (suggesting that the degree or quality of proof necessary to negate the presumptions of the business judgment rule may be less where the plaintiff attacks the applicability of the rule because of self-dealing or personal interest of the directors). Indeed, the plaintiff who attacks the applicability of the business judgment rule because of self-dealing or personal interest may have an easier battle than the plaintiff who alleges a breach with respect to duties normally associated with the duty of care. Where self-dealing or personal interest is shown, the burden shifts to the defendant-directors to prove entire fairness. Where only a breach of the duty of care is asserted, the burden of proof remains with the plaintiff to show that the defendants were grossly negligent in performing their duties. The plaintiff has a much greater chance of successfully challenging a board's decision when the burden is on the directors to justify that their actions were in accordance with the business judgment rule, than when the burden is on the plaintiff to show the contrary. This is why the court's determination of which standard to apply—the intrinsic fairness test or the business judgment rule—often determines the outcome of the suit. See AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 111 (Del. 1986) ("Because the effect of the proper invocation of the business judgment rule is so powerful and the standard of entire fairness so exacting, the determination of the appropriate standard of judicial review frequently is determinative of the outcome of derivative litigation.").

70. Aronson, 473 A.2d at 812 n.6.

71. See Terrell, supra note 59, at 345 (asserting that the Aronson court was in part responsible for "adding bricks to the citadel of the business judgment rule" because of its holding that director liability cannot be predicated on simple negligence, absent self-dealing).
Just three months after *Aronson*, the Delaware Supreme Court held that the business judgment rule, as discussed in *Aronson*, was "equally applicable . . . in the context of a takeover." In *Pogostin v. Rice*, the court did not state its rationale for applying the rule to a board's decision to reject a tender offer and apparently viewed such a decision to be no different from any other board decision. The traditional business judgment rule, with its favorable presumptions and placement of the initial burden on the party challenging the transaction, was held applicable to a board's defensive actions in the face of a takeover attempt. Hence, under the rule of *Pogostin*, unless the plaintiff could establish that the directors acted with the sole or primary purpose of perpetuating themselves in office or some other reason why the rule would not apply, the defensive measure would not be enjoined, and liability would not be imposed on the

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72. *Pogostin v. Rice*, 480 A.2d 619 (Del. 1984). In this case, the plaintiffs challenged the defendant-directors' rejection of a tender offer. As in *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984), the court confronted the issue of whether demand was excused—an issue not within the scope of this comment. However, the decision, albeit temporarily, provided defendant directors with the protection of the traditional business judgment rule when its defensive actions were challenged. The Delaware Supreme Court affirmed the court of chancery's dismissal for failure to make demand on the board, after stating that "an informed decision to reject a takeover proposal, hostile or friendly, will not excuse demand absent particularized allegations of a breach of fiduciary duty, such as self-dealing, fraud, overreaching, or lack of good faith." *Pogostin*, 480 A.2d at 627. Thus the business judgment rule was held to protect a board's decision to reject a tender offer, unless the plaintiff alleged facts with particularity in his complaint that perpetuation in office was the directors' sole or primary motive. *Id.* This is no longer the case, after *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

73. 480 A.2d 619 (Del. 1984).

74. *Id.* at 627.

75. *Id.* If the plaintiff could establish a primary purpose of entrenchment on the part of directors, then the burden would shift to the directors to show that the defensive action was fair to the corporation. But see *Cheff*, 199 A.2d at 555 (placing the burden on directors to demonstrate that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed, where the directors repurchased stock at a premium from a shareholder threatening a takeover). Initially, the rule announced in *Cheff* was limited to the specific facts there involved. The rule only applied in actions seeking to hold directors personally liable where the directors were charged with improper use of corporate funds. *Id.* at 556 ("corporate funds may not be used to advance an improper purpose"). In *Cheff*, the directors used corporate funds to repurchase stock at a premium from a threatening shareholder, a situation now commonly referred to as paying greenmail. *Id.* However, it should be noted that the *Cheff* rule later formed the basis for the standard adopted in *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985), which has been applied in actions seeking injunctive relief, and to all defensive actions taken by a board in response to a takeover attempt. See infra note 79.
It was not long, however, before the court retreated from this position.

C. Unocal Corp. v. Mesa Petroleum Co.—Alteration of the Traditional Business Judgment Rule

In *Unocal Corp. v. Mesa Petroleum Co.*, the Delaware Supreme Court retreated from the position it had taken just one year earlier in *Pogostin* and significantly altered its application of the business judgment rule in the takeover context. The court recognized that when a board of directors is confronted with a takeover attempt, there is a substantial likelihood that a board will act primarily in its own interests, rather than those of the corporation and its stockholders. Implicit in the *Unocal* decision is an acknowledgement that a board’s decision to adopt a defensive measure is different from a normal business decision because the directors may be influenced by personal concerns over job security and may implement defensive

76. *Pogostin*, 480 A.2d at 627. The business judgment rule would also not apply under *Pogostin* if the plaintiff could show that the directors acted in bad faith, were uninformed, did not exercise due care, or abused their discretion. *Id.*

77. 493 A.2d 946 (Del. 1985).

78. The *Unocal* case involved a takeover attempt headed by T. Boone Pickens, Jr., president and chairman of the board of Mesa Petroleum Company. *Id.* at 949 n.1. Mesa made a two-tier “front loaded” cash tender offer for 37% of Unocal Corporation’s outstanding stock at a price of $54 per share. *Id.* at 949. Unocal’s Board of Directors, consisting of a majority of independent outside directors, rejected Mesa’s tender offer as inadequate, and later adopted a selective stock repurchase plan (a self-tender offer for the corporation’s own shares) in defense. *Id.* at 950. Under the plan, if Mesa acquired a certain number of shares, Unocal would repurchase the remaining shares of its stock at $72 per share in debt securities. *Id.* at 951. Mesa was excluded from tendering its shares into the exchange offer, while the directors of Unocal tendered their shares. *Id.* Mesa filed suit challenging the exchange offer, and Mesa’s exclusion therefrom, as a breach of the fiduciary duties the Unocal Board owed to Mesa as a minority shareholder. *Id.* at 953. Mesa contended that the business judgment rule was inapplicable because the directors, by tendering their own shares, would receive a financial benefit not available to all shareholders, since Mesa was a shareholder and was excluded. *Id.*

79. Although the “enhanced duty” rule announced in *Unocal* was applied to a target board’s adoption of a stock repurchase plan in response to a takeover attempt, both the language of the court’s opinion, and subsequent applications of *Unocal* indicate that the standard equally applies to any defensive action taken by a board of directors to defend against a takeover attempt or potential takeover attempt. See *id.* at 955. See also *Moran*, 500 A.2d at 1356 (applying the *Unocal* standard to a target board’s adoption of a preferred share purchase rights plan, commonly referred to as a “poison pill,” as a defense against potential hostile tender offers).

measures simply to entrench themselves.81 With this in mind, the court viewed Pogostin's automatic and unqualified application of the traditional business judgment rule in the takeover context as inappropriate.82

Unocal's retreat from the Pogostin holding, however, was not a complete abandonment.83 Although the court recognized the inherent conflict of interest that confronts directors when a threat to their control is involved,84 it refused to apply automatically the intrinsic fairness test to such situations, even though that is the standard normally applied where director self-interest is shown.85 Rather, in

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81. A successful takeover attempt often results in a replacement of incumbent directors and officers. Therefore, a successful defense to a takeover attempt serves to protect existing directors from losing their jobs and control of the corporation. It is not only financial personal interests that may influence directors' responses to takeover attempts. Directors' desire to retain the power and prestige of their positions may also contribute to their decisions to defend against takeover attempts. Also, directors may harbor personal feelings against the particular corporation or individual making the takeover attempt, that incite the board to defeat the attempt at all costs. See Johnson & Siegel, supra note 10, at 525 n.30 (discussing the different motives that may influence directors' decisions in the takeover context). Hence, it is not only the directors holding other employment positions with the corporation, which they are likely to lose if a takeover is successful, who may be motivated by personal interests. It is the possibility, indeed the likelihood, that such motives are present among all directors when confronted with a takeover attempt, that supported the Unocal court's imposition of an enhanced duty on the directors. Although such motives are not absent from other decisions directors make, the likelihood of their presence is not as great as it is when a takeover is threatened. See Easterbrook & Fischel, The Proper Role of a Target's Management in Responding to a Tender Offer, 94 Harv. L. Rev. 1161, 1198 n.106 (1981) (noting that the decision whether to oppose a tender offer is different even from other "interested" director transactions such as the setting of salaries or the making of contracts with related entities; suggesting that such decisions must be made by the directors regardless of the inevitable conflict of interest because shareholders have neither the time, expertise, or desire to make such decisions, whereas the decision to oppose a tender offer can and should be made by the shareholders).

82. Unocal, 493 A.2d at 954.

83. The court held that the business judgment rule still applies in the context of a takeover, but altered its application. See id.

84. Id. at 955.

85. See Sinclair Oil Corp., 280 A.2d at 720. See also Aronson, 473 A.2d at 812 (stating that the business judgment rule does not apply where directors "expect to derive any personal financial benefit from [a transaction] in the sense of self-dealing, as opposed to a benefit that devolves upon the corporation or all shareholders generally"). In Unocal, the court could have justifiably applied the intrinsic fairness test to the board's adoption of the selective self-tender offer. Since Mesa was a shareholder of Unocal and was not permitted to tender its shares to the self-tender, while the directors could, and did, tender their shares, the court quite plausibly could have concluded that the directors expected to derive a personal financial
its attempt to balance the board’s authority and duty to protect the corporation from harm reasonably perceived against the potential harm to shareholders caused by the potential conflict of interest among directors responding to a takeover attempt, the Delaware Supreme Court adopted an intermediate standard of review where a board’s defensive actions are challenged.86 Rationalizing its modification of the traditional business judgment rule, the court stated: ‘‘Because of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.’’87

The court announced a two-prong threshold test, transferring the initial burden of proof to the defendant-directors to show that: (1) they had ‘‘reasonable grounds for believing that a danger to corporate policy and effectiveness existed’’,88 and (2) the defensive benefit not shared with all shareholders, and that the intrinsic fairness test should therefore apply. Aside from the exclusionary aspect of the self-tender offer, the court also could have found that the board’s retention of control as a potential result of the self-tender was an expected benefit not devolving on all shareholders, warranting application of the intrinsic fairness test.

The appropriate standard of review in cases where directors’ defensive transactions are challenged is the subject of much debate and disagreement. As the Unocal court notes, much of the debate focuses on conflicting views of the proper role of directors in responding to a takeover attempt. See Unocal, 493 A.2d at 954 n.9. On the one extreme is the view that a board should remain passive, and that all defensive actions taken by a board should constitute a breach of the duty of loyalty. See Easterbrook & Fischel, supra note 81. This view was expressly rejected by the Unocal court. See Unocal, 493 A.2d at 954 (“[A] board of directors is not a passive instrumentality.”). On the other extreme is the view that a board’s decisions made in response to a takeover threat are the same as any other decisions the board makes, therefore the traditional business judgment rule should equally apply in the takeover context. See Hansen Trust PLC v. ML SCM Acquisition Inc., 781 F.2d 264 (2d Cir. 1986) (New York case illustrating how New York courts place the burden of proof on the party challenging directors’ defensive measures to show a breach of fiduciary duties, in accordance with the traditional business judgment rule). See also Lipton, Takeover Bids in the Target’s Boardroom: An Update After One Year, 36 Bus. Law. 1017, 1023-26 (1982) (arguing that defensive tactics that defeat tender offers do not injure shareholders because the price of the target’s shares will often rise to more than the tender offer, and concluding that the business judgment rule should provide the target directors with the freedom to evaluate and reject tender offers on the same basis that they make any other decision).

86. See Unocal, 493 A.2d at 954.
87. Id.
88. Id. at 955. The court stated that this first burden is satisfied upon a showing that the directors acted in good faith and upon reasonable investigation.
measure chosen was "reasonable in relation to the threat posed."\textsuperscript{69} Under this test, both prongs have to be satisfied to invoke the protection of the business judgment rule. If the board satisfies its initial burden, then the burden of proof shifts 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 such as fraud, overreaching, lack of good faith or being uninformed . . . ."\textsuperscript{70} If the board is unable to

\textit{Id.} (quoting Cheff v. Mathes, 41 Del. Ch. 494, 506, 199 A.2d 548, 554-55 (1964)). The court also stated that approval of the defensive measure by a majority of outside independent directors will "materially enhance" proof of this burden. \textit{Id.}

89. \textit{Id.} This prong of the \textit{Unocal} test requires that the board analyze the "nature of the takeover bid and its effect on the corporate enterprise." \textit{Id.} The court listed a number of factors that a board may consider in conducting its analysis, including the

- inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on "constituencies" other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, . . . the quality of securities being offered in the exchange, [and] the basic stockholder interests at stake, including those of short-term speculators, whose actions may have fueled the coercive aspect of the offer at the expense of the long-term investor.

\textit{Id.} at 955-56. With respect to the last factor, the court, by implication, seemed to suggest that the board's decision need not be controlled by the potential short-term profits of its investors.

In Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1988), the court articulated the permissible board considerations with some variations:

Circumstances may dictate that an offer be rebuffed, given the nature and timing of the offer, its legality, feasibility and effect on the corporation and the stockholders; the alternatives available and their effect on the various constituencies, particularly the stockholders; the company's long term strategic plans; and any special factors bearing on stockholder and public interests.

\textit{Id.} at 1285 n.35.

90. \textit{Id.} at 958. In applying its new standard, the \textit{Unocal} court found that the \textit{Unocal} Board met its burden under both prongs. In finding that the board had reasonable grounds for believing a threat to corporate policy existed, the court focused on the board's conclusion that Mesa's two-tier tender offer of $54 at the front end was inadequate, and recognized the coercive nature of two-tier tender offers in general where the second tier is financed by junk bonds. \textit{Id.} at 956.

In addition, the court found it significant that the threat was posed by a "corporate raider with a national reputation as a 'greenmailer,'" referring to Mr. Pickens. \textit{Id.} (The court defined "greenmail" as "the practice of buying out a takeover bidder's stock at a premium . . . not available to other shareholders in order to prevent a takeover." \textit{Id.} at 956 n.13.) In finding that the selective self-tender offer adopted by the board was reasonable in relation to the threat posed, the court signified that if the board had not excluded Mesa from tendering its shares to Mesa's self-tender offer, then the board's objective of defeating the Mesa
satisfy its initial burden, the intrinsic fairness test will apply and the burden will remain with the board to prove that all aspects of the defensive measure were entirely fair.\(^9\) 

Hence, the favorable presumptions of the traditional business judgment rule once afforded directors at the outset have been replaced in the takeover context by an enhanced duty rule\(^9\) that requires the defendant-directors, not the plaintiff, to bear the initial burden of proof.\(^9\) Since much of the protection of the rule stems from the initial placement of the burden of proof on the party challenging the transaction, the \textit{Unocal} decision was viewed as a severe limitation on directors responding to a takeover attempt.\(^9\) The degree of proof

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91. \textit{Ivanhoe Partners}, 533 A.2d at 606-07. 
92. See BNS Inc. v. Koppers Co., 683 F. Supp. 458, 473 (D. Del. 1988) (noting that when a board’s response to a takeover attempt is challenged, "before directors may rely on the presumptions accorded them by the business judgment rule, the Delaware courts require the directors to overcome two additional hurdles."); \textit{Moran}, 500 A.2d at 1356 ("[I]n \textit{Unocal} we held that when the business judgment rule applies to adoption of a defensive mechanism, the initial burden will lie with the directors."). 

93. Placing the initial burden of proof on the defendant-directors is not novel to the judicial review of directors’ decisions. In \textit{Cheff} v. Mathes, 199 A.2d 548 (Del. 1964), the Delaware Supreme Court placed the initial burden on the directors to show that they had reasonable grounds for believing that a threat to corporate policy existed, where the directors repurchased stock at a premium from a shareholder threatening a takeover. The \textit{Unocal} court increased this initial burden and extended its application. The burden imposed in \textit{Cheff} is embodied in the first prong of the \textit{Unocal} standard. \textit{Unocal}, 493 A.2d at 955. But the \textit{Unocal} court placed an additional initial burden on the directors, with the second prong of its standard, to show that the defensive measure adopted was reasonable in relation to the threat posed. \textit{Id}. Furthermore, whereas \textit{Cheff} only applied to defensive repurchase programs initiated by directors, the \textit{Unocal} standard applies to all defensive measures taken by directors in response to a takeover attempt. \textit{See id}. (announcing the second prong of its new standard, the court broadly stated: "If a defensive measure is to come within the ambit of the business judgment rule,"’ suggesting that the standard will apply to all defensive measures). (emphasis added). \textit{See also Ivanhoe Partners}, 535 A.2d at 1341 ("Since this case involves the actions of a board of directors in the face of a takeover, the . . . claim must be analyzed under the . . . standard of \textit{Unocal}."); \textit{Johnson & Siegel}, supra note 10, at 330 n.51 (recognizing that while Delaware has had a long-standing policy of placing the initial burden of proof on those with a conflict of interest, \textit{Unocal} is a departure from previous Delaware cases in classifying challenges to corporate control as conflict of interest transactions).

94. \textit{See} sources cited \textit{supra} note 9. Indeed, the \textit{Unocal} decision seemed to
required to satisfy the two-prong test of Unocal, as well as the standard of conduct that the enhanced duty rule of Unocal indirectly imposes on directors, will doubtlessly be further developed through case law. However, subsequent application of the Unocal standard suggests that the directors’ burden is easily satisfied, and the instances when their decisions will not be protected by the business judgment rule are few.\textsuperscript{95}

III. Analysis

A. The Facts

Ivanhoe Partners v. Newmont Mining Corp.\textsuperscript{96} involved a hostile tender offer by Ivanhoe Partners and Ivanhoe Acquisition (collectively Ivanhoe), both controlled by T. Boone Pickens, Jr.\textsuperscript{97} The target of this takeover attempt was Newmont Mining Corporation (Newmont).\textsuperscript{93} In response to the tender offer, Newmont’s Board of Directors adopted a three-pronged defensive strategy that was the subject of this litigation.\textsuperscript{99} The defensive strategy included a $33 per share dividend declaration to be financed by a sale of Newmont’s non-gold assets;\textsuperscript{100} a “street sweep”\textsuperscript{101} of Newmont stock at $98 per share by Consolidated Gold Fields PLC (Gold Fields), Newmont’s largest shareholder, which was facilitated by the dividend and brought Gold Field’s ownership up from 26% to 49.7%;\textsuperscript{102} and an amendment to

contravene one of the rationales underlying the business judgment rule: that courts should not second-guess directors’ decisions because they are ill-equipped to analyze and review business decisions. See Block & Prussin, The Business Judgment Rule and Shareholder Derivative Actions: Vice Zapata?, 37 Bus. Law. 27, 32-33 (1981) (discussing the rationales underlying the business judgment rule). The second prong of the Unocal test requiring judicial analysis of the seriousness of a threat and the reasonableness of a board’s response to that threat, seems to require such proscribed second-guessing.

95. See cases cited supra note 11.
96. 535 A.2d 1334 (Del. 1987).
97. Id. at 1336-37.
98. Id. at 1336. Newmont Mining Corporation is one of the largest gold producers in North America. Id.
99. Id. at 1337.
100. Id.
101. A “street sweep” is “the rapid acquisition of securities on the open market during and shortly after the pendency of a tender offer for the same class of securities.” Id. at 1337 n.3. The shares are usually purchased at a premium from arbitrageurs. Id.
102. Id.
an existing standstill agreement\textsuperscript{103} between Gold Fields and the Newmont Board.\textsuperscript{104} These defensive tactics would effectively defeat Ivanhoe’s tender offer.\textsuperscript{105} Ivanhoe challenged the board’s defensive measures in Delaware’s chancery court as entrenchment devices in breach of Newmont’s and Gold Fields’ fiduciary duties owed to Newmont shareholders, seeking to enjoin the measures.\textsuperscript{106}

Some historical facts pertaining to the relationship between Newmont and Gold Fields are important for a full understanding of the challenged transactions, which occurred in 1987.\textsuperscript{107} In 1981 Gold Fields began acquiring Newmont stock and announced its intention to acquire up to just under 50%.\textsuperscript{108} Newmont sued to enjoin Gold Fields’ acquisition but later resolved the dispute, allowing Gold Fields to acquire up to one-third of its shares, in return for a standstill agreement.\textsuperscript{109} Under this standstill agreement, among other things, Gold Fields was prohibited from acquiring more than 33 1/3% of Newmont’s stock.\textsuperscript{110} Significantly, Gold Fields was given the option to terminate the agreement if a third party acquired 9.9% or more of Newmont’s stock.\textsuperscript{111}

On August 15, 1987, Ivanhoe announced that it had acquired 8.7% of Newmont stock and shortly thereafter deliberately increased its holdings to 9.95%, thereby freeing Gold Fields to terminate the standstill agreement.\textsuperscript{112} At this point, Newmont’s directors perceived...

\textsuperscript{103} A standstill agreement is an agreement between a large shareholder and a board of directors, governing the conduct of the shareholder. See Franklin, \textit{supra} note 13, at 5, col. 2. Such cooperative pacts may serve as defensive alliances against a common threat. \textit{Id.}

\textsuperscript{104} \textit{Ivanhoe}, 535 A.2d at 1340. Pursuant to the amendment, Gold Fields’ representation on the board was limited to 40%, it was required to support the board’s nominees for board positions, and it was prohibited from transferring its interest to a third party who refused to be bound by the standstill agreement. \textit{Id.}

\textsuperscript{105} \textit{Id.} at 1337.

\textsuperscript{106} \textit{Id.}

\textsuperscript{107} The chancery court opinion, reported at 533 A.2d 585 (Del. Ch. 1987), more fully details many of these facts, and thus the summary which follows relies on both the chancery court and supreme court opinions.

\textsuperscript{108} \textit{Ivanhoe}, 533 A.2d at 591.

\textsuperscript{109} \textit{Ivanhoe}, 535 A.2d at 1338.

\textsuperscript{110} \textit{Id.} The standstill agreement also restricted Gold Fields’ representation on the Newmont Board to one-third of the directors, and gave Newmont the right of first refusal if Gold Fields decided to sell its interest. \textit{Id.} In 1983, the agreement was amended and extended until 1993. \textit{Id.}

\textsuperscript{111} \textit{Id.}

\textsuperscript{112} \textit{Id.} Ivanhoe intentionally increased its holdings to 9.95%, hoping that Gold Fields would then ally itself with Ivanhoe once it was free from the standstill agreement. \textit{Id.}
both Ivanhoe and Gold Fields as potential threats since there was the risk that Ivanhoe, Gold Fields, or both acting together, would acquire a controlling interest in Newmont.\textsuperscript{113} Newmont's directors decided not to sell the company, but to keep it independent, and to oppose any effort by Ivanhoe to take control of Newmont.\textsuperscript{114} Hence, Newmont began to implement several traditional defensive measures, keeping Gold Fields' questionable alliance in mind.\textsuperscript{115}

Finally, Ivanhoe launched its main attack on Newmont.\textsuperscript{116} On September 8, 1987 Ivanhoe commenced the first tier of a hostile two-tier tender offer, seeking 42\% of Newmont at $95 per share.\textsuperscript{117}

\begin{itemize}
\item \textsuperscript{113} Ivanhoe Partners, 533 A.2d at 592.
\item \textsuperscript{114} Id. at 593.
\item \textsuperscript{115} Ivanhoe, 535 A.2d at 1338. As the Delaware Supreme Court noted, "Newmont found itself in the peculiar position of having simultaneously to fear and to court Gold Fields." Id. Since Gold Fields was no longer bound by the standstill agreement, it was free to buy Newmont stock on the open market sufficient to gain control of Newmont, or it could sell its shares in Newmont to Ivanhoe. Id. The Newmont Board did not want either of these possibilities to occur, therefore it exempted Gold Fields from the defensive measures adopted, in order to avoid pushing Gold Fields in either of these directions. Id. at 1339. One of the traditional defenses implemented was the board's approval of "golden parachute" agreements with 25 key members of management, which called for substantial severance payments if someone other than Gold Fields acquired more than 20\% of Newmont's stock. Ivanhoe, 533 A.2d at 592 n.5. Newmont also sent a letter to its shareholders reporting a 14\% increase in gold reserves, a 45\% increase in production forecasts, and an aggressive program to effectuate those production objectives. Id. at 594.

\item \textsuperscript{116} On August 31, Ivanhoe initiated its main attack with a "bear hug" letter which proposed that Ivanhoe acquire the remaining Newmont common stock through a negotiated transaction. Ivanhoe, 533 A.2d at 594. The Newmont Board met on September 7 to consider possible strategies and retained Goldman Sachs and Kidder, Peabody & Co., Inc., to act as independent financial advisors. Id. at 595. Newmont's management discussed and developed an aggressive capital investment program (the Gold Plan) which entailed raising Newmont's 1988 gold production estimates by 50\% above 1987 levels, and accelerating exploration and reserve activities. Id. at 595. It is significant that these estimates provided a basis for Newmont's financial advisor to increase its initial valuation of Newmont stock. Id. at 595 n.9. As the Delaware Supreme Court recognized, the valuation by Goldman Sachs was a much disputed issue. Ivanhoe, 535 A.2d at 1339 n.12. Although the court conceded that the increased estimates of the Gold Plan were timed to defeat the Ivanhoe offer, it rejected Ivanhoe's contention that the estimates were "mere puffery." Id. at 1339 n.11. The Gold Plan was only discussed at the September 7 meeting and was not adopted until the meeting of September 10. Ivanhoe, 533 A.2d at 595. However, at the September 7 meeting the board did approve an agreement with several banks, which provided that if an entity other than Gold Fields acquired 50\% or more of Newmont, the several loans could be deemed in default. Ivanhoe, 535 A.2d at 1338-39 n.7.

\item \textsuperscript{117} Ivanhoe, 535 A.2d at 1339. This would increase Ivanhoe's Newmont holdings to 51\%. Ivanhoe, 533 A.2d at 595. The second tier provided that all
Newmont's nine-member board of directors—consisting of three "inside" management directors, two outside directors affiliated with Gold Fields, and four independent directors—met to consider Ivanhoe's offer. The board concluded that the offer was inadequate and voted to recommend that the shareholders reject it, based in part upon a presentation by its independent financial advisor, Goldman Sachs. Ivanhoe responded by raising its tender offer to $105 per share, under the same terms as its first offer.

On September 16, the Newmont Board met to consider Ivanhoe's amended offer. At this meeting, the board considered a revised financial analysis of the value of Newmont shares by Goldman Sachs, which took into account the impact of the recently adopted and announced "Gold Plan," which was an aggressive capital investment program. Based in part upon this analysis, the board found the remaining shares would be acquired at $95 cash, however, there was no specific proposal for a second step transaction, aside from the price to be offered, and no firm commitment to devise one. Ivanhoe, 535 A.2d at 1339.

118. Ivanhoe, 535 A.2d at 1339 n.10.
119. Ivanhoe, 533 A.2d at 596. It is significant to note that the two Gold Fields directors recused themselves from the board and did not attend any Newmont Board meetings from September 8, when Ivanhoe's first offer was made, until after September 20, 1987. Id. Thus, the decisions concerning the tender offers and the various defensive measures were made by a Newmont Board consisting of a majority of independent ("outside") directors who were not affiliated with either Gold Fields' or Newmont's management. Id. at 591.

The board's stated reasons for rejecting the September 8 Newmont offer were that (i) the offer was inadequate relative to the values in the company, . . . enhanced by the . . . Gold Plan, (ii) shareholder interests would be best served by Newmont remaining independent so that shareholders could reap the benefits of the company's future expected profitability, (iii) the Ivanhoe offer had uncertainties and was potentially coercive because of the absence of any commitment for a "second step" acquisition, and (iv) the board believed that it was in a better position to adopt an alternative restructuring program that would provide greater short term value to shareholders while permitting them to share in Newmont's long run profitability.

Id. at 596 n.11.

At the September 10 meeting, the board formally adopted the Gold Plan and issued a press release disclosing the same. Id. at 596 n.11. Also, the board began exploring alternatives with Gold Fields aimed at preventing the termination of the standstill agreement. Ivanhoe, 535 A.2d at 1339.

120. Ivanhoe, 535 A.2d at 1339.
121. Ivanhoe, 533 A.2d at 597. Goldman Sachs' first valuation of Newmont shares resulted in values of $103 to $107. Id. at 597 n.12. At the September 18 meeting, where Ivanhoe's $105 offer was considered, Goldman Sachs presented a valuation of $110 to $114, the increase being attributable to its consideration of the impact of the Gold Plan, and the resultant increase in the market price of Newmont's publicly traded stock. Id.
$105 tender offer price to be inadequate.\textsuperscript{122} During this meeting, Newmont's management also proposed a "restructuring" plan designed to deal with the joint threat of Ivanhoe and Gold Fields.\textsuperscript{123} The plan consisted of a large $33 per share dividend financed by a sale of Newmont's non-gold assets, combined with the execution of a new standstill agreement with Gold Fields to guarantee Newmont's independence.\textsuperscript{124} The dividend was designed to serve two main purposes: reducing Newmont's liquidity, making it a less attractive target; and providing Gold Fields with funds which it could use to purchase Newmont shares on the open market, i.e., to "sweep the street."\textsuperscript{125}

Attracted by the prospect of increasing its Newmont holdings with only a limited capital investment, Gold Fields agreed to an amended standstill agreement on September 20, 1987.\textsuperscript{126} On September 21 and 22, in accordance with the agreement and facilitated by the dividend, Gold Fields "swept the street," increasing its Newmont holdings to 49.7\%.\textsuperscript{127}

On September 23, Ivanhoe filed suit, seeking an injunction or rescission of the dividend and the "street sweep," on the ground that these actions violated the fiduciary duties owed by Newmont directors and Gold Fields\textsuperscript{128} to the shareholders of Newmont.\textsuperscript{129} The

\textsuperscript{122} Ivanhoe, 535 A.2d at 1339.
\textsuperscript{123} Id.
\textsuperscript{124} Id. Proceeds of a sale of Newmont's non-gold assets would finance the dividend. Id.
\textsuperscript{125} Id. at 1339-40. Since Gold Fields had already considered terminating the standstill agreement and going into the open market on its own to gain control of Newmont, the dividend became "the linchpin for negotiating [a] new standstill agreement," since it would reduce the capital investment that would be required if Gold Fields were to act alone. Id. at 1340. Hence, the dividend was a means of thwarting Ivanhoe's offer, as well as a bargaining tool in negotiations with Gold Fields to prevent it from acquiring a controlling interest in Newmont.
\textsuperscript{126} Id. at 1340. This new standstill agreement allowed Gold Fields to purchase up to 49.9\% of Newmont stock, limited its representation on the Newmont Board to 40\%, and required Gold Fields to vote all of its shares for the Newmont Board's nominees for remaining board positions. Id. Also, Gold Fields was prohibited from transferring its interest to a third party who refused to be bound by the new standstill agreement. Id. The September 20 standstill agreement was delivered to Gold Fields in escrow, conditioned upon Newmont's declaration of the $33 dividend. Ivanhoe, 533 A.2d at 598.
\textsuperscript{127} Ivanhoe, 533 A.2d at 1340.
\textsuperscript{128} Gold Fields was alleged to be equally culpable as a fiduciary, or as an aider and abettor. Ivanhoe, 533 A.2d at 600.
\textsuperscript{129} Id. Specifically, a breach of the duty of loyalty was alleged on the ground
Delaware Court of Chancery granted Ivanhoe's motion for a temporary restraining order, which halted trading by Gold Fields in Newmont stock and the consummation of the sweep, on the ground that the standstill agreement would entrench Newmont's management and would effectively avert any hostile takeover attempt for up to ten years. Consequently, Gold Fields and Newmont amended the standstill agreement on September 27. As a result of the amendments, the temporary restraining order was vacated, and the court of chancery denied Ivanhoe's motion for a preliminary injunction.

The Delaware Supreme Court accepted the expedited interlocutory appeal and upheld the court of chancery's denial of the preliminary injunction. The court held that the Newmont Board's tripartite defensive measure—consisting of the dividend issue, the standstill agreement, and the "street sweep"—was reasonable in relation to the reasonably perceived threats posed by Ivanhoe and Gold Fields. Since Ivanhoe did not demonstrate that the Newmont directors were solely or primarily motivated by entrenchment motives, the court held that the business judgment rule protected their actions.

B. Rationale

In determining whether the three-pronged defensive strategy adopted by the Newmont directors constituted a breach of their

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that corporate assets were used for the purpose of entrenching the directors in office. Id. Ivanhoe also alleged that fiduciary duties were breached by Newmont's effecting a "lock-up," by preventing a bidding contest that would bring Newmont stockholders the highest price for their shares, and by discriminating among contenders for control. Id. Additionally, Ivanhoe alleged that Gold Fields coerced the selling shareholders, and used undisclosed material inside information. Id. Finally, Ivanhoe alleged that the defensive measures adopted were not responsive to any reasonably perceived threat, in violation of the fiduciary duties imposed by Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). Id.

130. Ivanhoe, 533 A.2d at 608-09. The court of chancery specifically found two aspects of the standstill agreement entrenching: the restriction upon Gold Fields' transfer to any third party unless there was an agreement to be bound by the standstill, and the requirement that Gold Fields vote for the board's nominees. Ivanhoe, 535 A.2d at 1340.

131. Ivanhoe, 535 A.2d at 1340. The revised standstill agreement of September 27 allowed Gold Fields to tender its shares to any offer if the offeror had firm commitments for financing and provided that an effort would be made to establish cumulative voting. Id.

132. Id. The vice-chancellor held that the amendments cured the breach of fiduciary duty caused by the earlier agreement. Id.

133. Id. at 1346.

134. Id. at 1345.

135. Id.
fiduciary duties, the Delaware Supreme Court analyzed the board's actions under the enhanced duty standard established in Unocal. The court rejected Ivanhoe's contention that the intrinsic fairness test applied to the challenged transactions because there was no proof that the directors appeared on both sides of the transaction or that they derived any personal financial benefit not devolving upon the corporation and shareholders generally. Rather, the court applied the business judgment rule and because the actions of a board of directors in the face of a takeover were involved, the modified business judgment rule of Unocal was applied. Applying the Unocal two-prong standard, the court placed the initial burden on the Newmont Board to show that the threatened takeover posed a danger to corporate policy and effectiveness, and

136. Id. at 1341. See supra text accompanying notes 78-85 (discussing the Unocal standard).

137. Id., 535 A.2d at 1341. Ivanhoe alleged that the standstill agreement tainted the Newmont directors with a personal interest, requiring the transactions to be reviewed under the stricter standard of intrinsic fairness.

138. Id. (citing Weinberger v. UOP, Inc., 457 A.2d 701 (1983)). In Weinberger, the Delaware Supreme Court applied the intrinsic fairness test after finding that the defendant-directors stood on both sides of the challenged transaction between the parent corporation and its subsidiary, and received a benefit in the form of information not made available to the stockholders generally. Weinberger, 457 A.2d at 710. The court articulated the intrinsic fairness test as placing a dual burden on the defendant-directors to show both fair dealing and fair price. Id. at 711. The defendant-directors in this case failed to meet their difficult burden. Id. Significantly, the court noted that the result may have been different had there not been directors common to both the parent's and the subsidiary's boards, and had the subsidiary appointed an independent negotiating committee of outside directors to deal with the parent corporation. Id. at 709 n.7. In Ivanhoe, the fact that the board consisted of a majority of disinterested directors, and that the Gold Fields' directors recused themselves from the board's decisions on matters in which Gold Fields had an interest, i.e., the standstill agreement, saved the directors from the sharp teeth of the intrinsic fairness test, as well as helped to satisfy the directors' Unocal burdens. Also, there was no self-dealing with respect to the dividend, because any financial benefit the directors received from the dividend was equally shared by the corporation and stockholders generally. Ivanhoe, 533 A.2d at 602. See supra text accompanying notes 66-67 (discussing the intrinsic fairness test).

139. The court reaffirmed the holding of Fogelstein, 480 A.2d at 627, that the business judgment rule applies in the takeover context, but also reaffirmed the holding of Unocal Corp. v. Mesa Petroleum, 493 A.2d 946 (Del. 1985), which limited the application of the business judgment rule in the takeover context by requiring directors to establish a threat to corporate policy and defensive measures which are reasonable. Ivanhoe, 533 A.2d at 1341.

140. Id., 535 A.2d at 1341. The court reaffirmed its position that when directors oppose a hostile takeover, there is a substantial likelihood that the board may act primarily in its own interest rather than those of the corporation. Id. (citing Unocal, 493 A.2d at 954).
that the defensive measures adopted were reasonable in relation to the threat posed, before conferring the protections of the business judgment rule to the board's defensive actions.\textsuperscript{141}

In conducting its inquiry under the first prong of the \textit{Unocal} standard, the court examined the reasonableness of the board's perception that two threats existed: Ivanhoe and Gold Fields. With respect to Ivanhoe, the court found that the Newmont Board had reasonable grounds to conclude that the Ivanhoe offers were inadequate and not in the best interests of the corporation or its shareholders.\textsuperscript{142} This holding was based in part on the vice-chancellor's finding that the Newmont Board in good faith determined Ivanhoe's offer to be inadequate after reasonable investigation.\textsuperscript{143} The court recognized the coercive nature of two-tier tender offers in general, and believed that Ivanhoe's offer fit the mold perfectly.\textsuperscript{144} The court also found significant the board's awareness that the offeror was T.

\textsuperscript{141} \textit{Id.} The court noted that these burdens are met by showing good faith and reasonable investigation. \textit{Id. See infra} text accompanying notes 216-26 (discussing how the court may have misspoken in suggesting that both prongs of the \textit{Unocal} test can be met by showing good faith and reasonable investigation).
\textsuperscript{142} \textit{Id.} at 1342.
\textsuperscript{143} \textit{Id.} The court of chancery found that the Newmont Board reasonably perceived both Ivanhoe and Gold Fields as threats, after a reasonable deliberative process, carried out in good faith. \textit{Ivanhoe}, 533 A.2d at 607. The vice-chancellor noted that the process used to evaluate the Ivanhoe offer included a series of meetings by the Newmont Board, consisting of a majority of outside independent directors, and presentations by its independent financial advisor, Goldman, Sachs and Company. Therefore, the vice-chancellor held that the board's conclusion that the Ivanhoe offer was inadequate as to price, and that there were superior alternatives for Newmont shareholders, was reasonable. \textit{Id.}
\textsuperscript{144} \textit{Ivanhoe}, 535 A.2d at 1342. The term "two-tier tender offer" refers to the situation where an offeror makes a tender offer for enough shares to acquire control of a corporation (over 50\%) at one price ("tier one"), and announces an intention to purchase the remaining shares in a second step ("tier two"), usually subject to some sort of contingency. \textit{See} \textit{BNS}, 683 F. Supp. at 468 n.23. Such offers are referred to as "front-loaded" when the price to be paid for shares in the second tier is lower than that of the first, or is the "same" price but is to be paid with debt securities or is made subject to a contingency. \textit{Id.} Such offers are coercive because shareholders can be pressured into selling their shares in the first stage of the tender offer, for fear that a second stage "freeze-out" at a lower price will follow—forcing the shareholders who did not tender in the first tier to accept a smaller amount of cash, or debt securities, for their shares. \textit{Id.} The coercive aspect of Ivanhoe's offer derives from its unequal treatment of nontendering shareholders. The second-step transaction was subject to obtaining financing and there was no firm commitment to conduct a second step at the same price. Hence, shareholders who chose not to tender their shares in the first tier would face a number of risks, such as losing the opportunity to sell their shares at a premium above market price, or having to accept debt securities for their shares. \textit{Ivanhoe}, 535 A.2d at 1339.
Boone Pickens, who had a reputation for takeover attempts resulting in "greenmail" payments.145

With respect to Gold Fields, the court also found that the board had reasonable grounds for believing a threat to corporate policy and effectiveness existed.146 The court recognized the reality of the threat posed by Gold Fields, despite Gold Fields' public support for Newmont management, because of Ivanhoe's deliberate acquisition of 9.95% of Newmont shares, which freed Gold Fields to cancel the 1983 standstill agreement and either ally itself with Ivanhoe, or gain control of Newmont on its own through open-market share purchases.147 In addition, the Newmont Board was aware that Gold Fields had the necessary financial backing to conduct a "street sweep" on its own.148 Hence, the court concluded that it was reasonable for the board to perceive Gold Fields, as well as Ivanhoe, as a threat, and that the board met its burden under the first prong of the Unocal standard.

In determining whether the Newmont Board's response was reasonable in relation to the threats posed by both Ivanhoe and Gold Fields, as required by the second prong of the Unocal standard, the court scrutinized the $33 dividend, the amended standstill agreement, and the "street sweep," collectively as a unitary response.149 Prior to initiating this inquiry, the court found that the Gold Fields directors' recusal from the Newmont Board meetings, leaving a board consisting of a majority of independent, disinterested directors, was significant to the outcome of the case.150 Consistent with earlier decisions, the court stated that the approval of a board consisting of a majority of disinterested directors materially enhances proof that the board acted in good faith and upon reasonable investigation.151

145. *Ivanhoe*, 535 A.2d at 1342. The court noted how the "bear hug" letter and the coercive partial tender offer were perceived by the board as "classic elements of Mr. Pickens' typical *modus operandi.*" *Id.*

146. *Id.*

147. *Id.* The court also noted that Gold Fields had in fact considered selling its interest to Newmont or purchasing control of Newmont independently. *Id.*

148. *Id.* The court of chancery noted that Gold Fields had arranged for the necessary financing with First Boston in case it decided to increase its holdings in Newmont, and prepared a notice of termination of the standstill agreement. *Ivanhoe*, 533 A.2d at 607.

149. *Ivanhoe*, 535 A.2d at 1343.

150. *Id.* The remaining board consisted of four independent ("outside") directors and three management ("inside") directors. *Id.*

151. *Id.* (citing *Polk*, 507 A.2d at 537). It is interesting to note that the court
The court first examined the $33 dividend payment and found that it was reasonable in relation to the threat posed. This finding was based on the fact that the dividend served two purposes in thwarting Ivanhoe’s inadequate and coercive tender offer. First, it precluded Ivanhoe from acquiring Newmont’s gold assets at a premium, to the detriment of Newmont’s stockholders. Since the dividend was to be financed by the sale of Newmont’s non-gold

made reference to the good faith and reasonable investigation standards in conducting its inquiry under the second prong of the Unocal test, whereas in Unocal these elements were only considered in determining whether the first prong of the test had been satisfied. See Unocal, 493 A.2d at 955. See infra text accompanying notes 216-26 (discussing this inconsistency).

152. Ivanhoe, 535 A.2d at 1343. The court of chancery noted that the business judgment rule, not the intrinsic fairness test, applied to the dividend payment since there was no self-dealing; the dividend was paid to all shareholders, including Ivanhoe, in proportion to their interest. Ivanhoe, 533 A.2d at 602. See Del. Code Ann. tit. 8, § 170 (1983) (authorizing directors to declare and pay dividends out of the corporation’s surplus or out of net profits).

153. Ivanhoe, 535 A.2d at 1343. Once again the court seemed to give a lot of weight to the fact that the board had been informed by an independent financial advisor that the offer was inadequate. See supra note 149. Goldman Sachs issued its opinion that Ivanhoe would acquire the two Newmont gold subsidiaries at an 8.7% discount at Ivanhoe’s offer price of $105 per share. Ivanhoe, 535 A.2d at 1339 n.12.

154. Ivanhoe, 535 A.2d at 1343. The situation where an acquiror sells the target’s assets, dismantling the target after acquisition, and realizing a profit equal to the difference between its acquisition cost and the net proceeds from the sale of assets, is commonly referred to as a “bust-up.” See BNS, 683 F. Supp. at 468 n.23.

Less than three months after the Ivanhoe decision, the Delaware legislature enacted § 203 of the Delaware General Corporation Law, which prevents an acquiror from immediately selling the target’s assets in order to pay off its acquisition debt, with limited exceptions. See Del. Code Ann. tit. 8, § 203 (1988). Section 203 was enacted to discourage the type of coercive two-tier tender offer, such as the one made by Ivanhoe for Newmont, where the offeror can compel stockholders to sell their stock at a price below that which they might otherwise receive in an uncoerced environment. It attempts to achieve this by preventing certain business combinations between an interested stockholder and the target corporation for a three year period, unless one of the exceptions to the statute applies. See id. See also BNS Inc. v. Koppers Co., 683 F. Supp. 458 (D. Del. 1988) (holding that a tender offeror was not likely to prevail on the merits with respect to his claim that § 203 of the DGCL violates the Williams Act and the commerce clause). If Ivanhoe’s tender offer was successful, and § 203 applied, Ivanhoe would not have been able to effect the second-tier of its offer, or sell off Newmont’s assets, for three years after its acquisition of 15% of Newmont stock, without approval by the Newmont Board or the stockholders of Newmont. See id. at 464. Section 203 would not effect Gold Fields, however, since it had held more than 15% of Newmont stock for more than three years at the time of the “street sweep,” and the board approved the transaction. See Del. Code Ann. tit. 8, § 203(a) (1988).
assets, these previously undervalued assets would not be available to pay off Ivanhoe's acquisition debt, if Ivanhoe successfully acquired control of Newmont and its gold assets.\textsuperscript{155} Hence, the dividend reduced Newmont's liquidity, making it a less attractive target.\textsuperscript{155} Second, the dividend provided Gold Fields with the necessary cash to conduct the "street sweep" and increase its holdings to 49.9\%, thereby preventing Ivanhoe from acquiring a controlling interest through its tender offer.\textsuperscript{157}

The court next examined the standstill agreement and found that it was a reasonable response to the threat posed by Gold Fields. The court reasoned that the agreement guaranteed Newmont's continued independence\textsuperscript{158} and protected Newmont's shareholders from a potential squeeze out in a second-step transaction by Ivanhoe.\textsuperscript{159}

Finally, the court analyzed the "street sweep" and concluded that the Newmont Board's facilitation of it was a reasonable response to the Ivanhoe threat.\textsuperscript{160} The court rejected Ivanhoe's assertions that

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  \item \textsuperscript{155} \textit{Ivanhoe}, 535 A.2d at 1343.
  \item \textsuperscript{156} Id. at 1339-40.
  \item \textsuperscript{157} The "street sweep" by Gold Fields was possible because Ivanhoe had to wait until the end of the federally prescribed tender offer period before it could purchase more shares. \textit{Ivanhoe}, 533 A.2d at 606. There was no such restriction on Gold Fields, who was free to purchase the additional 23\% immediately, since Gold Fields already owned 28\%, and did not have to comply with the rules applicable to tender offerors. \textit{See Williams Act}, Pub. L. No. 90-439, 83 Stat. 454 (1982). As the court notes, the SEC has unsuccessfully challenged street sweeps as a violation of the Williams Act. \textit{Ivanhoe}, 535 A.2d at 1337 n.3 (citing Hanson Trust PLC v. SCM Corp., 774 F.2d 47 (2d Cir. 1985)). The court recognized that while Gold Fields had the financial ability to make the Newmont share purchases without the dividend, it was reluctant to make such a large capital investment. Id. at 1343.
  \item \textsuperscript{158} \textit{Ivanhoe}, 535 A.2d at 1343. The court noted that the agreement stopped Gold Fields from purchasing a controlling interest in Newmont on the open market and restricted Gold Fields' Board membership to 40\%. An independent board of directors was ensured, consisting of 40\% Gold Fields directors, 20\% management nominated directors, and 40\% independent directors. Id. The court also upheld the provisions of the September 20 standstill agreement requiring Gold Fields to cash its votes for the Newmont Board's director-nominees, and restricting Gold Fields' ability to transfer its Newmont stock free of the standstill agreement. Id. at 1345-46. The court disagreed with the vice-chancellor's determination that these provisions had entrenching effects, in violation of the directors' duty of loyalty, reasoning that these provisions only perpetuated the independent nature of the board. Id.
  \item \textsuperscript{159} Id. at 1343.
  \item \textsuperscript{160} Id. at 1343-44. Although the "street sweep" was conducted by Gold Fields alone, the court treated it as part of Newmont's comprehensive defensive strategy. Id. at 1343.
the shareholders were coerced into selling their shares to Gold Fields\footnote{161} and that Gold Fields had the benefit of material inside information in conducting the “street sweep.”\footnote{162} Also, the court reasoned that the “street sweep” was an “essential part of Newmont’s defensive plan which enabled Newmont to maintain its independent status for the benefit of its other stockholders.”\footnote{163} Hence, the court held that all of the defensive measures satisfied the second prong of the \textit{Unocal} test because they were essential to the Newmont Board’s plan to thwart the takeover.\footnote{164}

The court then addressed Ivanhoe’s assertion that the Newmont directors breached the duties imposed on them by \textit{Revlon Inc. v. MacAndrews & Forbes Holdings, Inc.}\footnote{165} While recognizing that \textit{Revlon},

\begin{quote}
161. The court agreed with the vice-chancellor’s determination that the affidavits of arbitrageurs who sold their shares in the street sweep, failed to prove that they would have tendered to Ivanhoe’s offer if not for their awareness of the standstill agreement. \textit{Id.} The court of chancery believed that the rush to sell to Gold Fields was explicable on other grounds; some shareholders may have preferred to sell all of their shares for an immediate $98 per share, rather than to sell only 42% of their shares for a possible $105 at a later time. \textit{Ivanhoe}, 533 A.2d at 605.

162. The court again agreed with the vice-chancellor’s findings that Gold Fields had no access to confidential material information, and the financial information that was given to Gold Fields by Newmont was “obsolete and immaterial” at the time of the street sweep. \textit{Ivanhoe}, 535 A.2d at 1343.

163. \textit{Id.} at 1344.

164. Ivanhoe also claimed that Gold Fields breached its fiduciary duty to the Newmont shareholders who sold in the street sweep. \textit{Id.} The court disagreed and recognized that a shareholder only owes a fiduciary duty to other shareholders under Delaware law if he owns a majority interest or exercises control over corporate business. \textit{Id.} Gold Fields had neither a majority interest nor control over the corporation’s business and, therefore, owed no fiduciary duty to other shareholders of Newmont. \textit{Id.} The court also recognized that a stockholder is permitted to act in his own self-interest, and Gold Fields had an interest in deterring the threat posed by Ivanhoe’s coercive offer, even at the cost of a restrictive standstill agreement. \textit{Id.} The court noted, however, that Gold Fields could have been held liable to Newmont shareholders as one who knowingly joined with a fiduciary in a breach of a fiduciary duty. \textit{Id.} But since the court found that Newmont had breached no fiduciary duty, Gold Fields could not be held liable for any breach. \textit{Id.}

165. 506 A.2d 173 (Del. 1986). In \textit{Revlon}, the Delaware Supreme Court held that when the break-up of a corporation is inevitable, the duty of the board of directors changes from preservation of the corporation to maximization of the corporation’s value at a sale for the benefit of stockholders. \textit{Id.} at 182. A strict reading of the \textit{Revlon} decision reveals the questionable applicability of the \textit{Unocal} standard once \textit{Revlon}’s special duties are deemed to have arisen. After finding that a sale of Revlon had become apparent, the court stated that the board “no longer faced threats to corporate policy and effectiveness, \textit{or} to the stockholders’ interests . . . .” \textit{Id.} Since the first prong of the \textit{Unocal} standard requires directors to show that they reasonably perceived “a danger to corporate policy and effectiveness,”
when implicated, imposes a duty on directors to maximize the corporation’s value for the benefit of the stockholders, the court found that no sale of Newmont was inevitable, and therefore Revlon duties were not implicated. The court provided two reasons for this finding. First, the Newmont Board never decided to sell the corporation. Rather, the board maintained their objective to remain independent. Second, there was never a bidding contest nor a sale of Newmont. Here the court found it significant that Gold Fields was not a bidder, but only sought to protect its existing investment in Newmont. Gold Fields accomplished this by purchasing Newmont shares from private sellers, not from Newmont. The court also found that the Newmont Board’s facilitation of the street sweep with the $33 dividend did not constitute a “sale” because Gold

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Unocal, 493 A.2d at 955, it could be argued that the Unocal standard can never be satisfied once Revlon applies. However, this argument appears to be purely one of semantics, in light of the supreme court’s decision in Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1988). In Macmillan, the court confirmed that Revlon is an alteration, rather than an abandonment, of the Unocal standard. Id. at 1288. Presumably, the Unocal standard, as altered by Revlon, can be satisfied by showing that a particular takeover attempt posed a threat to the stockholders' interest in obtaining the highest value for their shares, and that the board's action was reasonable in relation to that threat. See id.

166. Ivanhoe, 535 A.2d at 1344 (citing Revlon, 506 A.2d at 182).

167. Id. at 1345. If Revlon had applied, it is unlikely that the board would have been able to justify its actions since the board's actions thwarted competitive bidding that may have resulted in a higher price for the shareholders' stock, and the Newmont Board's transactions with Gold Fields probably constituted favoritism of one potential bidder over another, which is prohibited by Revlon. See Revlon, 506 A.2d at 184 (stating that “favoritism for a white knight to the total exclusion of a hostile bidder” is not permissible). Certain defensive actions permissible under Unocal to thwart a threatening takeover attempt are not permissible under Revlon, where the only valid purpose is to maximize shareholder profit. See TW Servs., Inc. v. SWT Acquisition Corp., No. 10,427, slip op. at 23-24 (Del. Ch. Mar. 2, 1989) (recognizing that when a corporation is in the “Revlon mode,” it must “desist from steps . . . even if they might otherwise appear sustainable as an arguable step in the promotion of ‘long term’ corporate or share values.”).

168. Ivanhoe, 535 A.2d at 1345.

169. Id. The court focused on the standstill agreement, which limited Gold Fields to less than a controlling interest, and the other related defensive measures, as evidence of the board’s enduring effort to remain independent. Id. The court viewed this situation as distinguishable from that of Revlon, where the defensive measure was implemented after the directors had authorized management to “sell” the corporation. Id. at 1344.

170. Id.

171. Id.

172. Id.
Fields would not gain control of Newmont through the "street sweep," as mandated by the standstill agreement.\textsuperscript{173}

Finally, after finding that the Newmont directors had met both of its burdens under \textit{Unocal}, the court applied the business judgment rule to the board's three-pronged defensive measure.\textsuperscript{174} Hence, the court refused to substitute its judgment for that of the board, unless Ivanhoe could "demonstrate that the directors were solely or primarily motivated by entrenchment concerns, or another breach of the duty of loyalty or care . . . ."\textsuperscript{175} Because Ivanhoe failed to present such evidence, the court refused to enjoin the dividend declaration or the "street sweep" and affirmed the court of chancery's denial of Ivanhoe's motion for preliminary injunction.\textsuperscript{176}

\section{IV. Evaluation}

The Delaware Supreme Court's decision in \textit{Ivanhoe} is clear evidence that a board of directors can implement quite an arsenal of defensive tactics to thwart a takeover attempt without removing itself from the protective custody of the business judgment rule. On its face, the \textit{Unocal} standard severely limits the protection of the business judgment rule normally afforded to directors' decisions in other contexts by placing the initial burden on the directors to show the reasonableness of their actions when defensive tactics are challenged. However, the manner in which the Delaware Supreme Court has conducted inquiry under the \textit{Unocal} standard and the degree of proof

\textsuperscript{173} The court found it important that the standstill agreement only permitted Gold Fields to acquire up to 49.9\% of the corporation and limited its representation on the Newmont Board to 40\%. \textit{Id.} This raises an interesting issue not addressed by the court in \textit{Ivanhoe}. Would \textit{Revlon} have applied if the "street sweep" resulted in Gold Fields' gaining a controlling interest in Newmont? The question of exactly when a board's \textit{Revlon} duties arise, save the situation where the board has authorized a sale, has not yet been answered by the Delaware Supreme Court.

\textit{But see} Black & Decker Corp. v. American Standard, Inc., 682 F. Supp. 772, 781 (D. Del. 1988) (applying Delaware law, held that a transaction which results in a change in control of a corporation amounts to a "sale" under \textit{Revlon}). In \textit{Black & Decker}, the court imposed \textit{Revlon} duties on the board of directors where a defensive recapitalization plan resulted in management's obtaining 55.5\% control of the corporation. \textit{Id.} Therefore, because the \textit{Ivanhoe} court based its determination that no sale of Newmont occurred primarily on the fact that Gold Fields had not acquired a controlling interest in Newmont, it is likely that, had Ivanhoe acquired over 50\% of Newmont shares in its "street sweep," the court would have imposed \textit{Revlon} duties on the board.

\textsuperscript{174} \textit{Ivanhoe}, 536 A.2d at 1345.
\textsuperscript{175} \textit{Id.} (citing \textit{Unocal}, 493 A.2d at 958).
\textsuperscript{176} \textit{Id.} at 1346.
required for directors to satisfy both of its prongs, indicate that the standard is easily met, and its restrictions on the business judgment rule's applicability in the takeover context are relatively slight. The court's application of the Unocal standard in Ivanhoe clearly supports this proposition.

A. Satisfying Unocal's First Prong

In finding that the Newmont Board had satisfied the first prong of the Unocal standard, the court placed a great deal of significance on the fact that the offeror was T. Boone Pickens, Jr., and that the takeover maneuvers faced by the board were "classic elements of Mr. Pickens' typical modus operandi."177 This is not the first time that the Delaware Supreme Court has expressed its antipathy toward Mr. Pickens. In Unocal, the court suggested that any offer made by Mr. Pickens will constitute a reasonable basis for believing a threat to corporate policy and effectiveness exists: "Wholly beyond the coercive aspect of an inadequate two-tier tender offer, the threat was posed by a corporate raider with a national reputation as a 'greenmailer.'"178

It is questionable whether the court was giving weight to the Newmont Board's perception or the court's own recognition that Mr. Pickens had previously been involved in takeover attempts that resulted in greenmail payments or break-ups.179 Nevertheless, the court's decisions in Unocal and Ivanhoe suggest that where the tender offeror is a corporate raider with a reputation as a greenmailer, the

177. Id. at 1342.
178. Unocal, 493 A.2d at 956 (emphasis added). See Note, The Reasonableness of Defensive Takeover Maneuvers When the Corporate Raider is Mr. T. Boone Pickens: Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987), 57 U. Cin. L. Rev. 739, 759-60 (1988) (noting the fact that Mr. Pickens status as the offeror was likely a substantial factor in the court's decision in Ivanhoe).

Perhaps the court's statement that Mr. Pickens has a national reputation as a greenmailer is an understatement. It appears that Mr. Pickens now has an international reputation as a greenmailer. See, e.g., Brauchli & Kanabayashi, Pickens' Venture in Japan is Expected to Face Hostility from Nation's Firms, Wall St. J., Apr. 5, 1989, at G14, col. 7 (discussing Mr. Pickens' recent activities in Tokyo's stock market and how Japanese analysts are accusing him of greenmail).

179. It is possible that the court would still have found Mr. Pickens' reputation to be an important factor under Unocal's first prong, even if the Newmont Board itself was aware of it, given the court's deep-rooted animosity toward Mr. Pickens. Indeed, the first part of the court's rationale in Ivanhoe suggests that the pen unleashed against Mr. Pickens in the court's Unocal opinion still had some ink left in it. See Unocal, 493 A.2d at 956.
target board will have a less difficult time convincing the court that it reasonably perceived a threat.

The court in *Ivanhoe* also reaffirmed its view that two-tier partial tender offers are coercive in nature. The coerciveness of two-tier tender offers has been diminished somewhat by SEC Rule 14d-8, which extends the period during which tendered shares must be taken up pro-rata by anyone making a tender offer for less than all of the outstanding shares to the entire period the offer remains open. Previously, only those shareholders who tendered during the first ten days of a partial offer had proration rights under the Williams Act. Hence, Rule 14d-8 effectively eliminates the difference between partial (i.e., two-tier) tender offers and offers for any-or-all shares, since shareholders who do not tender in the first ten days will have proration rights, and therefore will not lose the opportunity to tender into the higher first-tier price.

Nevertheless, two-tier tender offers are still potentially coercive since a shareholder who does not tender during the twenty-day period will receive the second-tier price if the takeover is successful. Indeed, as one commentator recognizes, "any bid, apart from an any-or-all cash bid with a commitment to freeze out non-tendering shareholders at the bid price, may have some coercive effect on target shareholders." At least one court has gone even further in holding

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180. *Ivanhoe*, 535 A.2d at 1342 (citing *Unocal*, 493 A.2d at 956). In *Unocal*, the two-tier tender offer consisted of $54 per share in cash at the front end, and subordinated securities worth far less than $54 in the back end. *Unocal*, 493 A.2d at 956. The court there recognized this type of offer as a classic coercive measure designed to "stampede shareholders into tendering at the first tier, even if the price is inadequate, out of fear of what they will receive at the back end . . . ." *Id.*


183. See R. Gilson, The Law and Finance of Corporate Acquisitions 164 n.31 (Supp. 1988) (signifying that Rule 14d-8 has "eliminated the difference in premia between two-tier and any-or-all cash bids"); and Note, *supra* note 178, at 766 ("there is no longer any concern that by not tendering in the first ten days a shareholder will lose out on the higher price").

184. See Note, *supra* note 178, at 766 (recognizing that two-tier tender offers continue to have a coercive aspect despite SEC regulations extending proration rights).

185. Gilson, *supra* note 183, at 164. This commentator suggests that any partial offer without a freeze-out commitment for remaining shares, even a 100% cash offer at a substantial premium, is potentially coercive since a shareholder who believes the stock is worth more than the offer price may nevertheless tender his shares out of fear that he will otherwise be left holding minority shares in a controlled
that an inadequate offering price *alone* may constitute a sufficient threat under *Unocal*'s first prong.\(^{186}\) This decision indicates that even in the absence of any coercion in the form of a second-step freeze-out at a lower price, a board may still have a reasonable basis for perceiving a threat.\(^{187}\)

Ivanhoe's two-tier tender offer for Newmont was more clearly at the coercive end of the tender offer spectrum. The offer was for 42\% of Newmont at $105 per share, contingent upon Ivanhoe's obtaining financing.\(^{188}\) No specific second-step transaction had been devised, nor was there any commitment to conduct a second-step transaction.\(^{189}\) As the court of chancery noted, the risk perceived by

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corporation with a market value that has dropped below the offer price. *Id.* at 164 n.31. *See* Booth, *The Promise of State Takeover Statutes*, 86 Mich. L. Rev. 1635, 1646-47 (1988) (suggesting that even all cash tender offers for *all* shares are coercive because shareholders lack sufficient bargaining power and information to resist tendering their shares). *See also* Note, *supra* note 45, at 287 n.59 (listing several potential dangers posed by takeover attempts, including: a grossly inadequate price; a coercive or two-tiered offer; an offer supported by questionable or low-grade financing; a bust-up acquisition; extortion of greenmail; simple disruption of long-term corporate planning; and general social and economic ill effects). *See also* BNS, 683 F. Supp. at 468 n.23 (defining a "freeze-out" as the situation where a controlling shareholder forces minority shareholders to surrender their shares for cash or debt securities).

\(^{186}\) *See* BNS Inc., 683 F. Supp. at 475 ("[T]he inadequacy of the offering price does present a threat to the company and its stockholders."). In *BNS Inc.*, the court found that the target board had reasonable grounds for believing a threat existed, where the offer was a tender offer for all shares at $56 per share with a commitment to pay the same cash price to non-tendering shareholders. *Id.* at 461. The fact that the offer posed no risk to shareholders of being forced to sell their shares at a lower price in a second-step transaction did not stop the court from making this finding. *But see* Grand Metro. Publ. Ltd. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988). In *Pillsbury*, after finding that the target board had failed to show a threat to the corporate enterprise, Justice Duffy stated: "Whatever threat is involved relates entirely to the alleged 'inadequacy of the price offered' to Pillsbury stockholders." *Id.* at 1056. A preferred interpretation of this case is that only where no threat to the corporate enterprise is asserted by the target board, but there is asserted to be a threat to the shareholders, an inadequate offer price alone will not be sufficient to show a threat to corporate policy or effectiveness.

\(^{187}\) *See* City Capital Assoc. Ltd v. Interco, No. 10,105, slip op. at 25 (Del. Ch. Nov. 1, 1988) ("Even where an offer is noncoercive, it may represent a 'threat' to shareholder interests . . . .").

\(^{188}\) *Ivanhoe*, 535 A.2d at 1339. The fact that Ivanhoe's offer was contingent upon financing is significant in that *Unocal* lists the risk of nonconsummation of the offer as one of the factors a board may consider in its threat assessment. *See* *Unocal*, 493 A.2d at 955.

\(^{189}\) *Ivanhoe*, 535 A.2d at 1339. Although Ivanhoe did disclose an intention to acquire all remaining shares in a second step transaction at $105 per share, *id.*, the offer was still potentially coercive because of the lack of any commitment and the financing contingency.
the Newmont Board was that Newmont's minority shareholders would be left without protection against a subsequent "freeze-out" merger or other transaction at an unfair price. 190 Under the terms of Ivanhoe's offer, it was quite possible that shareholders would be coerced into tendering their shares in the first tier of the offer out of a realistic fear that either no second step transaction would be conducted, or that the second-step transaction would force the shareholders to accept debt securities for their shares. 191

The Delaware Supreme Court also emphasized that under Unocal's first-prong analysis, the vice-chancellor found that the board determined the offer to be inadequate in good faith and after reasonable investigation. 192 The vice-chancellor's finding was based primarily on three factors: (1) the Newmont Board consisted of a majority of disinterested directors; 193 (2) the process used to evaluate the adequacy of the Ivanhoe offer consisted of a series of meetings and discussions among the directors after consideration of independent financial and legal advice; 194 and (3) the board's decision that the Ivanhoe offer was inadequate was made after considering a valuation of Newmont stock made by an independent financial advisor. 195

The supreme court recognized that the valuation conducted by Goldman Sachs was a much disputed issue in this case. 196 The first valuation prepared by Goldman Sachs in evaluating Ivanhoe's $95 offer reflected values of between $103 and $107 per share of Newmont stock. 197 The second valuation, prepared to evaluate Ivanhoe's $105 offer, resulted in values of $110 to $114 per share. 198 The increase was attributable to Goldman Sachs' assessment of the impact of the

190. Ivanhoe, 535 A.2d at 592-93. See supra note 185 (for a definition of "freeze-out" merger).
191. See sources cited supra note 185 (discussing the coerciveness aspect of such offers).
192. Ivanhoe, 535 A.2d at 1342 (citing Ivanhoe 533 A.2d at 597 n.12).
193. Ivanhoe, 535 A.2d at 607. The two Gold Fields' directors recused themselves from the deliberations, leaving a board consisting of four independent "outside" directors and three management "inside" directors. Id. at 596.
194. Id. at 607.
195. See supra note 121 (discussing Newmont's per share value and the adequacy of Ivanhoe's offer as opined by Godman Sachs).
196. Ivanhoe, 535 A.2d at 1339 n.12.
197. Ivanhoe, 533 A.2d at 597 n.12.
198. Id.
Gold Plan.\textsuperscript{199} The Gold Plan was announced just five days before Ivanhoe’s second offer.\textsuperscript{200} Despite the fact that the Gold Plan included the disclosure of only speculative estimates of gold production increases and was timed to defeat Ivanhoe’s offer, the court refused to hold that Goldman Sachs’ valuation lacked an objective financial basis.\textsuperscript{201}

These findings illustrate the importance of independent financial advisors to a target board and the court’s reluctance to second-guess a board’s reliance on valuations prepared by such advisors in making a determination that an offer is inadequate.\textsuperscript{202} If a board relies on an independent financial advisor’s analysis suggesting an offer is inadequate, as part of the process leading to its determination that an offer is inadequate, it is unlikely that a court will make its own determination of whether the valuation is accurate, and the board’s reliance on such advice will go far in satisfying the burden under Unocal’s first prong.\textsuperscript{203}

After concluding that the Newmont Board had reasonable grounds for believing Ivanhoe’s offer posed a threat to the corporation and its shareholders, the supreme court also concluded that it was rea-

\textsuperscript{199} Id. The Gold Plan announcement caused an increase in the market price of Newmont stock, and Goldman Sachs increased valuation was based on this. Id. See supra notes 116, 121 (discussing the Gold Plan and its impact on Newmont’s per share value).

\textsuperscript{200} \textit{Ivanhoe}, 533 A.2d at 597 n.12.

\textsuperscript{201} \textit{Ivanhoe}, 535 A.2d at 1339 n.11. The court noted that the Gold Plan’s adoption and the resulting higher valuation “was not mere ‘puffery.’” Id. The court found it significant that under Goldman Sachs’ valuation, Ivanhoe’s $105 offer would have allowed Ivanhoe to acquire Newmont’s gold subsidiaries at an 8.7% discount. Id. at 1339 n.12. It is interesting to note that the court of chancery recognized the potential validity of Ivanhoe’s contention that the revised valuation was not based on “real” values, then countered this argument by merely stating that the claim was not supported by the evidence contained in the preliminary injunction record. \textit{Ivanhoe}, 533 A.2d at 597 n.12.

\textsuperscript{202} Indeed, § 141(e) of the DGCL provides that a director is permitted to rely on opinions and reports presented by “any . . . person as to matters the member reasonably believes are within such other person’s professional or expert competence and who has been selected with reasonable care . . . .” \textit{Del. Code Ann. tit. 8, § 141(e) (1988 Supp.).} It is interesting to note that Goldman Sachs issued an inadequacy opinion as to the offer made by Mr. Pickens in \textit{Unocal}, 493 A.2d at 950. Is it possible that the Newmont Board chose Goldman Sachs for this reason and, if so, would this not suggest lack of good faith? The court did not address this issue.

\textsuperscript{203} See Note, supra note 178, at 762-63 (recognizing that \textit{Unocal} and \textit{Ivanhoe} indicate that a target corporation will be justified in rejecting a tender offer as long as an independent analysis suggests the offer is inadequate, and the target’s board has evaluated it with some care).
sonable for the board to perceive Gold Fields as a threat. The court recognized the reality of this threat despite the formidable barriers that Gold Fields would have had to cross in order to acquire a controlling interest in Newmont, and despite the good relationship which had existed between Gold Fields and Newmont. In refusing to find the board’s perception unreasonable, the court focused on the board’s awareness of two factors. First, the board knew that Ivanhoe’s acquisition of 9.95% of Newmont freed Gold Fields to terminate the 1983 standstill agreement, and either ally itself with Ivanhoe, or gain control of Newmont on its own by conducting a unilateral “street sweep.” Second, the board was aware that Gold Fields had the requisite financial backing to gain control of Newmont. Thus, the court agreed with the board that Gold Fields posed a threat to Newmont shareholders since such shareholders might be left without protection against a subsequent “freeze-out” merger or other second-step transaction at an unfair price if Gold Fields acquired a controlling interest.

The supreme court’s application of the Unocal standard in Ivanhoe indicates that a target board should have little difficulty satisfying Unocal’s first prong. The court will look at the decision-making process employed by the directors in determining whether the board’s perception of a threat to the corporate enterprise was reasonable, rather than making its own determination of actual reasonableness. If a board consisting of a majority of disinterested directors establishes a record indicating that it evaluated an offer with due care, and

204. Ivanhoe, 535 A.2d at 1342.
205. Ivanhoe, 533 A.2d at 592 n.4. The vice-chancellor noted that in order to increase the holdings in Newmont beyond 49.9%, Gold Fields would have had to obtain stockholder approval, as required by its charter, and clearance from the London Stock Exchange and clearance from the United States Justice Department as required by the Hart-Scott Rodino Antitrust Improvement Act of 1976. Id. However, the court of chancery noted that such approval was attainable. Id.
206. Ivanhoe, 535 A.2d at 1342.
207. Id.
208. Id.
209. Id. Gold Fields could have acquired a controlling interest in Newmont, and then forced minority shareholders to surrender their shares for cash or debt securities. This threat was similar to the threat posed by Ivanhoe’s two-tier tender offer which provided no commitment to conduct a second-step transaction at the same price.
210. See Note, supra note 45, at 285 (referring to the first prong of Unocal as a duty of care inquiry, focusing on the objective conduct of target directors rather than on their subjective motivations).
considers the advice of an independent financial advisor before deciding that an offer is inadequate, it is likely that the board will satisfy Unocal's first prong if its decision to adopt a defensive measure is subsequently challenged.211 Moreover, if the offeror is a notorious corporate raider,212 such as Mr. Pickens, this fact alone may be sufficient to support a finding that there was a reasonable basis for believing a threat to the corporate enterprise existed.213

B. Satisfying Unocal's Second Prong

The second prong of the Unocal standard requires that the defensive measure adopted by the target board be reasonable in relation to the threat posed.214 Presumably, this prong entails a more substantive inquiry than that of the first prong because it appears to require the court to make its own determination of whether a given defensive measure is reasonable. On its face, it allows the court to reject a defensive measure regardless of the caution exercised by a board in assessing the nature of the threat posed, if the effects of the measure adopted, in the court's view, outweigh the perceived threat.215 Indeed, one Delaware Court of Chancery decision appears to require that the board's response offer stockholders a genuine choice if it is to satisfy the requirement of Unocal's second prong.216 However, as the supreme court's decision in Ivanhoe indicates, the court affords significant weight to a board's determination of what constitutes a reasonable response. In conducting its second-prong

211. See supra text accompanying notes 202-09.
212. See supra text accompanying notes 177-79.
213. Id.
214. Unocal, 493 A.2d at 955.
215. See Note, supra note 45, at 287 ("The reasonableness prong allows a court to strike down defensive tactics where the potential harmful effects of the tactics outweigh the threat identified by the board.").
216. See AC Acquisitions v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1985). In AC Acquisitions, the chancery court held that the target board's self-tender offer was not a reasonable response to the threat posed by the hostile tender offer under Unocal's second prong. Id. at 113. The court stated:

"It is reasonable to create an option that would permit shareholders to keep an equity interest in the firm, but, in my opinion, it is not reasonable in relation to such a "threat" to structure such an option so as to preclude as a practical matter shareholders from accepting the [hostile] offer."

Id. As will be discussed, this case is readily distinguishable from Ivanhoe in that the hostile offer was an all-cash offer for any-and-all shares of the target corporation, and the target board did not contend that the offer was coercive, nor that it was at an unfair price. Id. at 112.
inquiry, the court is reluctant to substitute its judgment for that of the board, and thus appears to allow a board to go quite far before the response will be deemed unreasonable.

In *Ivanhoe*, after restating *Unocal*'s second-prong requirement that the board’s response be reasonable in relation to the threat posed,\(^217\) the court next signified that the Newmont Board consisted of a majority of independent directors, and noted that this factor provided substantial proof that the board acted in good faith and upon reasonable investigation.\(^218\) The court surprisingly made reference to the good faith and reasonable investigation standards in conducting its second-prong inquiry, whereas in *Unocal* these elements were only considered in determining whether the first prong of the standard had been satisfied.\(^219\) Earlier in its opinion, the court similarly suggested that a showing of good faith and reasonable investigation satisfies *both* prongs of the *Unocal* standard.\(^220\)

One may question whether this was merely a judicial slip-of-the-pen in the name of opinion-writing efficiency, providing food for legal commentary but not legal precedent, or whether it was an intentional alteration of the requisite showings under the *Unocal* standard. In *Unocal*, the court stated that the second prong "entails an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise."\(^221\) This element of the *Unocal* standard has been referred to as the "proportionality test,"\(^222\) requiring the defensive measure to be proportional to, and balanced against, the reasonably perceived threat.\(^223\) It is unlikely that the

\(^{217}\) *Ivanhoe*, 535 A.2d at 1341 (citing *Unocal*, 493 A.2d at 954).

\(^{218}\) Id. (citing Polk, 507 A.2d at 537).

\(^{219}\) See *Unocal*, 493 A.2d at 955.

\(^{220}\) See *Ivanhoe*, 535 A.2d at 1341. Summarizing the board's *Unocal* burden, the court states:

This Court has addressed [the] potential for conflict by placing upon the directors the burden of proving that they have not acted solely or primarily out of a desire to perpetuate themselves in office, that the threatened takeover posed a danger to corporate policy and effectiveness, and that the defensive measures adopted are reasonable in relation to the threat posed. . . . The target directors must satisfy these prerequisites by showing good faith and reasonable investigation . . . .

*Id.* (emphasis added). See Note, *supra* note 45, at 288 (recognizing this apparent alteration in the requisite showings under the *Unocal* standard).

\(^{221}\) *Unocal*, 493 A.2d at 955.

\(^{222}\) City Capital Assoc., No. 10,105, slip op. at 21 (recognizing how the *Unocal* test has been "helpfully referred to as the 'proportionality test' ").

\(^{223}\) See *id.*
Ivanhoe court intended to state what a narrow interpretation of its opinion suggests; namely, that if a board can show that it reasonably perceived a threat, in good faith and after reasonable investigation, then any defensive measure adopted will be upheld, regardless of the nature of the threat posed.\(^{224}\) However, it is possible that the court intended to include the response/threat analysis as an element of reasonable investigation.

Despite the court’s statements concerning the requisite elements of proof under each prong of the Unocal standard, the court’s application of Unocal’s second prong in Ivanhoe indicates the deference that is given to a board’s determination of what defensive responses are reasonable. The court’s finding that the Newmont Board’s tripartite defensive measure—consisting of the $33 dividend payment, the restrictive standstill agreement with Gold Fields, and Gold Fields’ “street sweep”—was a reasonable response to Ivanhoe’s two-tier tender offer\(^{225}\) sends a message to target boards that they can implement aggressive defensive measures to prevent unwanted takeovers without having the reasonableness of its decisions second-guessed by a court. The Ivanhoe court did not weigh the economic impact of the board’s defensive measures against the economic impact of Ivanhoe’s offer on the shareholders.\(^{226}\) Rather, the court left the weighing process to the board, and found the measures to be reasonable because they were necessary elements in the board’s plan to remain independent by eliminating the threats posed by Ivanhoe and Gold Fields.\(^{227}\) Hence, Ivanhoe suggests that the second prong of Unocal does not require a judicial balancing of the defensive measure against the threat posed to ensure that the effect of the defensive measure is equal to, or less-than, that of the threat.

As established by Unocal and confirmed in Ivanhoe, a board of directors can consider a variety of factors in determining what de-

\(^{224}\) See Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988). In this case, although the chancery court found that the board had acted in good faith and upon reasonable investigation, it did not uphold the board’s refusal to redeem a poison pill. Id. at 1058-60. The court balanced the potential loss of $1.5 billion to shareholders caused by the board’s refusal to redeem the pill, against the threat caused by an all-cash tender offer for all shares, and held that the board failed to meet the second prong of Unocal. Id.

\(^{225}\) Ivanhoe, 535 A.2d at 1343-44.

\(^{226}\) See Franklin, supra note 13, at 5, col. 2. The court gave little consideration to the economic impact on shareholders caused by Gold Fields’ “street sweep” at $98 per share, see Ivanhoe, 535 A.2d at 1343-44, as opposed to its analysis of the impact caused if Ivanhoe’s $105 per share offer was successful. See id. at 1342.

\(^{227}\) Ivanhoe, 535 A.2d at 1344.
fensive measures are warranted. A board's implementation of defensive measures is not limited solely to opposing takeover attempts that have a coercive effect on the corporation's shareholders, as did the takeover attempts in Unocal and Ivanhoe. Therefore, although the "front-end" loaded two-tier tender offers involved in Unocal and Ivanhoe are infrequently used today, a board of directors that stays within the boundaries set by Unocal and Ivanhoe will still be able to adopt aggressive defensive measures to prevent unwanted takeovers without losing the protection of the business judgment rule.

C. When Revlon Duties Do Not Arise

In Revlon, Inc. v. MacAndrews & Forbes Holdings, the Delaware Supreme Court held that once a sale of the corporation becomes inevitable, a board's sole duty is to maximize current value for the shareholders. Exactly when this special duty arises remains largely an unanswered question in Delaware. In Ivanhoe, the court held that Revlon duties did not arise, even though the restructuring plan adopted by the board would result in Gold Fields owning 49.7% of Newmont's stock and having 40% control of Newmont's Board.

At first blush, the Ivanhoe court appears to have narrowly interpreted Revlon's applicability, allowing a target board to go quite far in transferring ownership and control of the corporation without implicating Revlon. Arguably, Ivanhoe supports the proposition that nothing short of a board's decision to transfer over 50% of the corporation's stock and majority control of the board will trigger Revlon. The Ivanhoe decision has been criticized as placing undue reliance on the form of the transaction, rather than its substance, in determining whether a Revlon-triggering sale has occurred.

228. See id. at 1341-42 (citing Unocal, 493 A.2d at 955-56). See supra note 89. See also Comment, Unocal Corp. v. Mesa Petroleum, 72 VA. L. REV. 851, 869 (1986) (criticizing Unocal's expansive definition of the corporation which includes creditors, customers, employees, and the community generally, in that it gives directors an unlimited degree of discretion).

229. See Intero, No. 10,105, slip op. at 25.

230. See id., slip op. at 23 (stating that "front-end" loaded partial offers have largely vanished).

231. 506 A.2d 173 (Del. 1986).

232. Id. at 182.

233. Ivanhoe, 535 A.2d at 1345.

234. Id. at 1340.

235. See Gilson, supra note 183, at 202. This commentator suggests that the Ivanhoe court erroneously refused to apply Revlon with the following statement:
A closer examination, however, reveals that the Ivanhoe decision is consistent with the policy concerns underlying Revlon. Moreover, the significance of the court's refusal to apply Revlon is greatly reduced in lieu of the unique factual situation before the court.236

The caselaw interpreting Revlon's applicability indicates that the imposition of Revlon's auctioneer duties seeks to protect a corporation's public shareholders from losing majority-shareholder status and being subjected to the risks inherent in holding minority shares, without at least an attempt by directors to maximize current value for the shareholders.237 In Mills Acquisition Co. v. MacMillan, 559 A.2d 1285 (Del. 1988), the court refused to apply Revlon duties to a buyout or recapitalization, recognizing that "special facts and circumstances" were present, and that the transaction's effect on minority shareholders was not consistent with the court's interpretation of Revlon.

Because management and Gold Fields together held a majority of Newmont's outstanding stock, and because for all practical purposes Gold Fields could neither tender to a hostile acquirer nor replace management in a proxy contest, the transaction had very much the same effect with respect to assuring target management's continued control as a management buyout or recapitalization.

Id. at 201.

236. See Mills Acquisition Co., 559 A.2d at 1285 n.35 (recognizing that Ivanhoe involved "special facts and circumstances"); R. Gilson, The Law and Finance of Corporate Acquisitions 164 (Supp. 1989) (recognizing that Ivanhoe's significance is "clouded by an idiosyncratic fact pattern").

237. See Black & Decker, 682 F. Supp. at 783 (applying Revlon duties signifying that the corporation's public shareholders would have lost control of the corporation and been relegated to minority status as a result of a recapitalization plan adopted by directors; Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 844-45 (Del. 1987) (refusing to apply Revlon duties in the context of a parent-subsidiary cash-out merger, recognizing that application of Revlon duties would have been futile since the parent corporation already held a controlling block of the subsidiary—and, accordingly, the shareholders of the subsidiary were already subject to the risks inherent in holding minority shares—such that the parent could block any effort by the subsidiary's directors to conduct an auction); Paramount Communications, Inc. v. Time Inc., Nos. 10,866, 10,670 & 10,935, slip op. at 60 (Del. Ch. July 14, 1989) (refusing to impose Revlon duties where directors approved a stock-for-stock merger transaction which would have placed 62% of the resulting corporation's stock in the hands of another corporation's stockholders, signifying that because control of the corporation would have remained in the market, "effecution of the merger would not have subjected [the] shareholders to the risks and consequences of holders of minority shares"), aff'd, No. 279 (Del. July 24, 1989).

In Time, the Time Board approved a stock-for-stock merger agreement with Warner Communications Inc., which would have resulted in former Warner shareholders owning 62% of the combined Time-Warner entity, and in former Warner directors holding 50% of the new entity's board positions. Id., slip op. at 56. In holding Revlon duties inapplicable, Chancellor Allen recognized that the transfer of Time shares would have been made directly to Warner shareholders, and that no control block of stock would have been transferred to any single shareholder or interrelated group; therefore, Time's shareholders would not have been subjected to the risks inherent in holding minority shares, such as the risk of being frozen out by a majority shareholder, as a result of the contemplated merger. Id., slip op.
Inc., the Delaware Supreme Court confirmed that a sale of corporate control triggers a board's Revlon duties, and indicated that substance will prevail over form in determining what constitutes a Revlon-triggering sale.

In Ivanhoe, the corporate-restructuring plan approved by the Newmont Board did not contemplate a change in corporate control, and Ivanhoe's public shareholders would not have been subjected to the risks inherent in holding minority shares as a result of the plan's implementation. The standstill agreement expressly limited Gold Fields' stock ownership in Newmont to 49.9%, and its representation on Newmont's Board to 40%. With Gold Fields' ownership of Newmont's common stock limited to less than a majority, and with an independent board of directors guaranteed by the standstill agreement, Newmont's public shareholders would continue to hold shares at 59-60. As the chancellor stated, "[C]ontrol of both [Time and Warner] remained in a large, fluid, changeable and changing market." Id., slip op. at 60. However, as the chancellor indicated in dicta, a Revlon-triggering change in control would have occurred if Warner were a private company, id., slip op. at 59, or if the stock-for-stock merger would have resulted in "a control block of stock in the hands of a single shareholder or a group with loyalty to each other," recognizing that such would have an effect on the financial value of the shareholders' stock. Id., slip op. at 60.

238. 559 A.2d 1261 (Del. 1988).
239. See id. at 1284, 1285. Macmillan is the first Delaware Supreme Court decision to state expressly that a sale of control constitutes a "sale" under Revlon: "In Revlon, we addressed for the first time the parameters of a board of directors' fiduciary duties in a sale of corporate control." Id. at 1284 (emphasis added). See Freedman v. Restaurant Assocs. Indus., Inc., [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,502, 97,218 (Del. Ch. 1987) [¶¶ 93,502, 97,218 or ¶ 93,502, at 97,218] (an earlier court of chancery decision stating that a sale of control triggers Revlon).
240. See Macmillan, 559 A.2d at 1285. The court stated that Revlon duties will arise "whether the 'sale' takes the form of an active auction, a management buyout, or a 'restructuring' such as that which the Court of Chancery enjoined in Macmillan I [Robert M. Bass Group, Inc. v. Evans, 552 A.2d 1227 (Del. Ch. 1988)]." The court's statement that the restructuring involved in Bass falls within its definition of a "sale" under Revlon, significantly indicates that a transaction involving a transfer of less than 50% of a corporation's stock will give rise to a board's Revlon duties, where the transaction will result in a transfer of effective control. In Bass, the vice-chancellor stated that the restructuring "would arguably trigger duties under Revlon" even though it would have resulted in management's owning less than a 50% block of stock, reasoning that management would have obtained voting control of the corporation. See Bass, 552 A.2d at 1243.
241. See Ivanhoe, 535 A.2d at 1340.
242. See id. The September 20 standstill agreement, approved of by the supreme court, established a board of directors consisting of 40% Gold Fields directors, 40%
in an independent corporation, undiminished in value by Gold Fields’ ownership. Application of Revlon duties in this context was simply unnecessary to protect the policy concerns underlying Revlon and the caselaw interpreting its rule.

Moreover, the unique factual situation present in Ivanhoe is readily distinguishable from the typical situations in which Revlon duties have been held applicable. Ivanhoe did not involve a situation where target directors took advantage of a takeover threat as an opportunity to increase their own equity interest in the target corporation, or that of a management or management-affiliated group.243 Gold Fields cannot properly be referred to as a management-affiliated group. Because Gold Fields was free to terminate the original standstill agreement and either ally itself with Ivanhoe or purchase control of Newmont independently, the Newmont Board perceived Gold Fields as a threat, and the court recognized the reasonableness of this perception.244 Also, as the court signified, the Newmont Board did not sell Newmont shares to Gold Fields; Gold Fields purchased

independent directors, and 20% Newmont directors. Gold Fields was also required to support the board’s nominees for the director positions not held by Gold Fields’ directors, and was prohibited from transferring its shares to any third party who would not agree to be bound by the standstill agreement. Id.

243. See Black & Decker Corp. v. American Standard, Inc., 682 F. Supp. 772 (D. Del. 1988) (applying Revlon duties where directors, in response to a hostile takeover attempt, adopted a recapitalization plan which would have increased management’s ownership in the target corporation from 4.8% to 23.9%, and given management control over 55.5% of the common stock, taking into account shares transferred to an ESOP); Freedman v. Restaurant Assocs. Indus., Inc., [1987-1988 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 93,502 (Del. Ch. 1987) (applying Revlon duties where a target board approved a leveraged buyout of 100% of the corporation’s stock by a management group which already owned 23% of the corporation's stock and 48% of the voting power); Edelman v. Fruehauf Corp., 498 F.2d 882 (6th Cir. 1966) (applying Revlon duties where target board approved a leveraged buyout of 77% of the corporation’s stock by a management group in response to a hostile tender offer); Robert M. Bass Group, Inc. v. Evans, 552 A.2d 1227 (Del. Ch. 1988) (signifying that Revlon duties would have applied where a target board adopted a restructuring plan in response to a hostile offer which would have increased management’s ownership to 39.2% and given management voting control in a resulting corporation).

244. See Ivanhoe, 535 A.2d at 1342. See also Macmillan, 559 A.2d at 1285 n.35 ("Newmont’s management faced two potentially coercive offers. In responding to such threats management’s efforts were viewed as reasonable decisions intended to guide the corporation through the minefield of dangers directly posed by one bidder, and potentially by another."). In Macmillan, the court confronted the argument that the corporate restructuring in Ivanhoe benefited management, stating that "at most this was a secondary effect." Id.
its shares of Newmont on the open market from private sellers.245

The corporate restructuring in Ivanhoe clearly was not a sale of corporate control, in form or in substance. Therefore, the Ivanhoe decision does not provide directors with a safety switch to keep Revlon's trigger from being pulled where they implement a transaction that is in substance a sale, while in form something else.

D. The Unocal Standard: An Effective Monitor?

The deference that is given to directors' decisions by the Delaware Supreme Court in applying the Unocal standard, as evidenced in Ivanhoe, is consistent with its longstanding policy of refusing to substitute its own business judgment for that of experienced corporate directors.246 One of the fundamental policies embodied in the business judgment rule is that directors who are familiar with the business of their corporation and who have experience in the business world are in a better position to make corporate business decisions.247 While the Unocal standard allows courts to review the substance of a board's decision and exercise their own judgment concerning the reasonableness of a board's decisions in the takeover context, courts have expressed their reluctance to do so.248

The Unocal standard, and the degree of proof required to satisfy its two prongs, have been criticized as ineffective at monitoring that which it was adopted to monitor; namely, whether the directors have authorized a transaction solely or primarily to preserve their control over the corporation.249 As one commentator, criticizing the degree of proof required under the first prong, states: "There is nothing in the combination of good faith and reasonable inquiry that prevents directors from giving undue weight to their own interests in retaining control of the corporation."250 The logic behind this criticism is that

245. See Ivanhoe, 535 A.2d at 1345.
247. See supra notes 41-44 and accompanying text (discussing the rationales underlying the business judgment rule).
248. See Interco, No. 10,105, slip op. at 22 ("Delaware courts have employed the Unocal precedent cautiously.").
249. See Comment, supra note 4, at 867.
250. Id. This commentator further criticizes the court's inquiry under the first prong stating that it is conducted as if the business judgment rule already applies: "[T]he court's formulation of the reasonable perception standard reintroduces the business judgment rule into the test of whether the business judgment rule should be applied at all." Id. See also Easterbrook & Fischel, supra note 81, at 1199 n.108
the *Unocal* standard was adopted because there is an increased likelihood that directors will act primarily in furtherance of their own interests; therefore, to allow directors to help satisfy the first prong of *Unocal* by showing that a majority of independent directors approved a defensive measure contravenes the purpose behind the standard's application. This logic, however, incorrectly assumes that independent directors are mere puppets of the "inside" directors, incapable of making independent decisions. Furthermore, the *Unocal* standard was not adopted to require directors to show that perpetuating control played no part in their defensive decisions; rather, it was adopted to ensure that this was not their sole or primary goal.251 Inherent in the *Unocal* standard is a recognition that directors can make decisions in the takeover context despite the conflict of interest they are faced with, and despite the fact that their actions incidentally serve to perpetuate their control, without losing the protection of the business judgment rule. Thus, the presence of objective factors, such as a board consisting of a majority of independent directors, and factors indicating that the directors have exercised due care and reasonable investigation, adequately dispel the likelihood that the directors acted with the sole or primary purpose of retaining control.

The court's application of the second prong of the *Unocal* standard has similarly been criticized as giving too much deference to a board's decisions as to the reasonableness of defensive measures.252 However, such deference is clearly warranted. The decisions made by directors in the face of a hostile takeover attempt are business decisions which the directors have both the power and the duty to make.253 While it is true that they should not have "unbridled discretion to defeat any perceived threat by any Draconian means available,"254 directors need to have the latitude to make the decisions they were elected to make, without having them second-guessed by the court in every instance. While the inherent conflict of interest faced by directors in responding to a takeover attempt may warrant placing the initial burden of proof on the directors, it does not

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252. *See Comment, supra* note 4, at 876-77.
warrant judicial intrusion into the substantive decisions of directors in every case. A court should be able to exercise its discretion in cases challenging directors' defensive measures, making its own determination of what responses are reasonable only when the particular facts so require. As Chancellor Allen stated:

The danger that [the Unocal standard] poses is, of course, that courts—in exercising some element of substantive judgment—will too readily seek to assert the primacy of their own view on a question upon which reasonable, completely disinterested minds might differ. Thus, inartfully applied, the Unocal form of analysis could permit an unraveling of the well-made fabric of the business judgment rule in this important context.255

Therefore, in situations such as Ivanhoe, where a board consisting of a majority of disinterested directors establishes a record indicating that it evaluated an offer with due care before deciding it to be inadequate and showing that the defensive measure was adopted in order to protect against a threat to a legitimate corporate concern, a court should not substitute its own views as to what defensive measures are reasonable under Unocal's second prong.

But some situations more clearly warrant a court's substantive inquiry into a board's determinations, such as where a board adopts a coercive defensive measure in response to a noncoercive takeover attempt and asserts no threat to the corporate enterprise posed by the takeover attempt. This was the situation present in AC Acquisitions v. Anderson, Clayton & Co.,256 where the court of chancery held that the target board's self-tender offer was an unreasonable response to the threat posed by a noncoercive hostile tender offer.257 Here, the court conducted its own balancing and carefully examined the board's response to determine whether it was proportional to the threat posed by the takeover attempt.258 This decision suggests that where no

255. Interco, No. 10,105, slip op. at 22.
256. 519 A.2d 103 (Del. Ch. 1986).
257. Id. at 114.
258. Id. at 112-13. The court found that the target board's self-tender offer at $60 per share was an unreasonable response to the threat posed by the all-cash tender offer at $56 per share because it effectively precluded shareholders from accepting the tender offer and was, therefore, coercive. Id. Although the court found that the board satisfied Unocal's first prong by asserting its purpose of providing an alternative for shareholders, id. at 112, it found that the second prong had not been satisfied because the alternative chosen did not provide the shareholders with any real choice. Id. at 114.
threat to the corporate enterprise is asserted, and the only threat stems from an alleged inadequate price offered, a court will conduct a more substantive review of a target board’s defensive decisions.\textsuperscript{259} Since the \textit{Unocal} standard clearly permits a court to exercise its discretion and make its own determination of what defensive measures are reasonable when the particular facts so require, it serves as an effective monitor of directors’ duty of loyalty in the takeover context.\textsuperscript{260}

V. Conclusion

In most contexts, the decisions of a corporation’s board of directors are insulated from judicial scrutiny by the business judgment rule. The protection afforded directors by the rule stems from its placement of the initial burden of proof on the party challenging the transaction to establish facts that rebut the rule’s favorable presumptions. In the takeover context, however, the Delaware Supreme Court has adopted the \textit{Unocal} standard which places the initial burden on the target directors to show that they had reason to believe that the resisted offer posed a threat to the corporate enterprise and that

\textsuperscript{259} \textit{See} Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988). In \textit{Pillsbury}, the court of chancery held that the board’s decision not to redeem a poison pill was not a reasonable response to the threat posed under \textit{Unocal}’s second prong. \textit{Id.} at 1060. As was the case in \textit{AC Acquisitions}, the Pillsbury Board did not meet its burden of proving a threat to corporate policy or effectiveness, and the only threat was to shareholders, relating solely to price. \textit{Id.} at 1056. Although the court found that the board had satisfied \textit{Unocal}’s first prong by showing that an independent board acted in good faith and made a reasonable investigation of the tender offer, \textit{id.}, the court carefully balanced the economic impact of the defensive measure (leaving the pill in place) against that of the tender offer under \textit{Unocal}’s second prong. \textit{Id.} at 1058. The tender offer was for all outstanding shares and for all cash at $63 per share. \textit{Id.} at 1052. The board developed a plan which, according to the board, would provide shareholders a better $68 value for their shares. \textit{Id.} at 1057. But as this plan was extremely speculative and uncertain, the court emphasized that leaving the pill in place could amount to a $1.5 billion loss to shareholders if the offer was withdrawn. \textit{Id.} at 1058. Therefore, according to the court’s balancing, the Pillsbury Board’s decision to leave the pill in place was an unreasonable response to the threat posed under \textit{Unocal}’s second prong, thus removing the protection of the business judgment rule. \textit{Id.} at 1060.

\textsuperscript{260} \textit{See} GILSON, supra note 183, at 160-63. This commentator questions whether the \textit{Unocal} standard is a substantive standard or is “merely another formal justification for defensive tactics that corporate planners must recite to succeed,” \textit{id.} at 160-61; concluding that recent Delaware Supreme Court cases indicate that the \textit{Unocal} standard calls for substantive review by the courts. \textit{Id.} at 163. \textit{But see} Johnson & Siegel, supra note 10, at 319 (concluding that courts employing traditional fiduciary duty analysis have been ineffective monitors of directors’ duty of loyalty).
the defensive measure chosen was reasonable in relation to that threat. On its face, the Unocal standard severely limits the protection available to directors in defending against unwanted takeover attempts. No longer can defendant directors walk into a Delaware court armed with the presumptions of the business judgment rule when their defensive antitakeover measures are challenged. However, as the Delaware Supreme Court’s decision in Ivanhoe indicates, the court, in applying the Unocal standard, gives substantial deference to the board’s determination of whether a threat existed and what defensive measures were reasonable. The standard does not require a judicial balancing of the defensive measure employed against the threat posed to ensure that the effect of the defensive measure is less than or equal to that of the threat.

In upholding the aggressive three-pronged defensive measure adopted by the Newmont Board, the court indicated that a board of directors can implement quite an arsenal of defensive measures to thwart a coercive tender offer without removing itself from the protective custody of the business judgment rule in Delaware. Following the guidelines articulated in Ivanhoe, a careful board of directors should have little difficulty satisfying its burdens under Unocal. Hence, Ivanhoe clearly suggests that the restrictions on the business judgment rule’s applicability in the takeover context are relatively slight, and the Unocal standard may have more bark than bite.

Scott P. Towers