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Articles

A Brief Introduction to the Fiduciary Duties of Directors Under Delaware Law

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Table of Contents

I. INTRODUCTION 838
II. GENERAL FIDUCIARY DUTIES OF DIRECTORS 841
  A. Duty of Care 842
  B. Duty of Loyalty 844
  C. Additional Duties of Directors Derived from the Duties of Care and Loyalty 847
    1. Duty of Good Faith 847
    2. Duty of Confidentiality 847
    3. Duty of Disclosure 848
III. DIRECTORS' DUTIES IN CONSIDERING AN M&A TRANSACTION 849
  A. Consideration of an Unsolicited Acquisition Proposal 849

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1. Directors Should Inform Themselves Prior to Deciding How (If at All) to Respond to an Unsolicited Acquisition Proposal 850
2. Directors Need Not Negotiate with Respect to, Nor Seek Alternatives to, an Unsolicited Acquisition Proposal............. 850
3. Directors May Have a Duty to Defend against an Unsolicited Acquisition Proposal... 851

B. Revlon Duties and the Revlon Standard of Review 852
1. Effects of *Revlon*.. 853
2. Complying with *Revlon* Duties 854

C. When Is a Corporation "Up For Sale" Such that Revlon Applies? 856
1. Cash Out Merger with a Controlling Stockholder.................. 856
2. Sale of a Controlled Corporation 857
3. Stock-For-Stock Merger 857

IV. FIDUCIARY DUTIES OF DIRECTORS OF DELAWARE CORPORATIONS IN CONNECTION WITH THE APPROVAL OF DEFENSIVE MEASURES 859
A. Enhanced Scrutiny under *Unocal* and Its Progeny....................... 859
B. Customary Deal Protection Devices 865
1. "No-Shop" and "No-Talk" Provisions 867
2. Termination Fees.. 868
C. Protections against Hostile Takeovers 869
1. Classified Boards and Other Shark Repellents....................... 871
2. Poison Pills.. 873

I. INTRODUCTION[4]

The negotiation of a high-profile merger transaction often bears surprising similarity to a romantic courtship.

Mergers often start innocently enough—a text message, a phone call, or perhaps an e-mail between rival CEOs. In one way or another, the "ask" is made. *Are you interested? Available? Can we work something out?* The exact words are not really important. On at least one occasion, simple doggerel has been used to start the conversation.[5]

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5. One of the more famous "asks" in recent history was in the form of a poem: "Roses are red, violets are blue; I hear a rumor, is it true." The line was included in an email sent from real estate mogul Samuel Zell to Steven Roth of Vornado Realty Trust to gauge Roth's interest in acquiring Zell's company, Equity Office Properties. Roth's response: "Roses are red, violets are blue. I love you Sam, our bid is 52." *See* Andrew

If the answer is "no," the parties typically will go their separate ways, perhaps leaving open the possibility of revisiting the idea at some point in the future. On occasion, however, a rejection can prompt hard feelings.

On the other hand, if the answer is "yes," the situation can often advance quickly. If the target and the suitor are a match, a deal can be agreed to and consummated in a matter of months or even weeks. If word should spread that the target corporation is not averse to courtship, other potential suitors may come forward and complications can ensue. In such circumstances, the directors of the target corporation often opt to resolve the choice presented by putting the fitness of the competing suitors to the test before making their decision. Secure in its knowledge of the available partners, and in order to evidence its commitment to the relationship, the target corporation may agree to terms designed to discourage third-party advances by including in the merger agreement defensive provisions such as termination fees, match rights, or "force-the-vote" provisions. Such provisions add a layer of protection to the declared relationship and proclaim the intent to go steady. The target that fears that the initial expression of interest could dissipate while an extensive search is undertaken may instead choose to sign an agreement that is subject to a condition subsequent. This allows the target to play the field by way of a post-signing market check or go-shop process, at least for a while before things get too serious.

The similarities to romantic courtship end upon consummation of the merger, however, for in the world of corporate mergers, neither divorce nor annulment is a realistic option. In the absence of highly unusual circumstances, Delaware law does not offer jilted bidders or unhappy stockholders the opportunity to secure rescission of a completed merger. Once the merger is complete, there is no turning back. Therefore, the board of directors, as the manager of the business and affairs of a Delaware corporation, must do its best to ensure that the decision to merge is the best option available under the circumstances with respect to the interests of the corporation and the stockholders as a whole. And those who would object (in the form of direct or derivative lawsuits) to a proposed merger typically to do so in advance in order to avoid finding themselves obligated to forever hold their peace.

The decisions that directors must make in connection with high-stakes mergers and acquisitions are frequently quite complex and challenging, but Delaware's extensive decisional law provides clear standards of acceptable conduct for fiduciaries facing such choices and

Ross Sorkin & Terry Pristin, *Takeover Battle Ends with Sale of Big Landlord*, N.Y. TIMES, Feb. 8, 2007, at A1.

equally clear standards for the judicial review of that conduct. A director who adheres to the fiduciary obligations required by Delaware law when reaching a decision (whether with respect to a merger transaction or otherwise) by acting on a fully informed basis, in good faith free of personal bias or interest, and in the honest belief that the action taken was in the best interests of the corporation and its stockholders can feel confident that his or her decision will receive some considerable measure of judicial deference, even if that decision should prove ill-advised when viewed in hindsight.

This Article seeks to examine Delaware's law of fiduciary duties and the practical implications of those duties in the context of negotiating merger transactions. Section I of this Article provides a brief introduction to the general fiduciary duties of directors under Delaware law. The fiduciary duties of care and loyalty are applicable to all board decisions, regardless of whether those decisions are made in the context of merger transactions or during the ordinary course of corporate business. Section I seeks to define these traditional fiduciary duties as well as certain ancillary duties that are derived from the duties of care and loyalty. Section I also includes a brief discussion of the standards of review generally applicable to the decisions of boards of directors under Delaware law.

Section II of this Article specifically addresses the duties of directors in the context of a merger transaction. In a transaction that will result in a sale or change of corporate control, the directors of a Delaware corporation must fulfill heightened "*Revlon* duties" to the corporation's stockholders.[6] The applicability of *Revlon* duties to a transaction affects both the board's duties and the standard of review that a court will apply to the transaction if it is challenged. Section II also discusses certain transactions which do not give rise to *Revlon* duties and considers whether directors ever have an affirmative duty to respond or negotiate with respect to an unsolicited acquisition proposal.

Section III of this Article discusses the duties of directors in adopting defensive measures either to protect a favored transaction, such as by including a termination fee, no-shop provision, or force-the-vote provision in a merger agreement, or to defend the corporation itself against hostile takeover attempts, such as by implementing a classified board or adopting a poison pill. In either case, a board's decision to adopt defensive measures must be reasonable and proportionate to the

6. *See* Revlon, Inc. v. MacAndrews & Forbes Holding, Inc., 506 A.2d 173 (Del. 1986).

threat posed.[7] Section III will also discuss the applicable standard of review and will provide examples of common defensive measures at both the transactional and enterprise level.

II. GENERAL FIDUCIARY DUTIES OF DIRECTORS

Except as otherwise provided under the General Corporation Law of the State of Delaware[8] (the "General Corporation Law") or a corporation's certificate of incorporation, the business and affairs of a Delaware corporation are managed by or at the direction of the corporation's board of directors.[9] In fulfilling their managerial responsibilities, directors of Delaware corporations are charged with a fiduciary duty to the corporation and to the corporation's stockholders.[10] Accordingly, the directors of a Delaware corporation entrusted with management responsibility must protect the interests of the corporation and effectively serve as "trustees" for the stockholders with respect to the interests of the stockholders in the corporation.[11]

When making corporate decisions, directors must fulfill the traditional duties of care and loyalty in order to satisfy their fiduciary obligations to the corporation and its stockholders. In certain situations, directors also have a duty to provide full and fair disclosure. A presumption exists under Delaware law that corporate directors act in accordance with these duties when making business decisions. This presumption is known as the "business judgment rule."[12] The business judgment rule is a deferential standard of review; Delaware courts will generally refrain from unreasonably imposing themselves upon the business and affairs of a corporation when the board's decision can be attributed to some rational corporate purpose.[13]

7. *See* Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946 (Del. 1985); Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995).

8. DEL. CODE ANN. tit. 8, §§ 101-398 (West 2011).

9. *Id*. § 141(a) (West 2010).

10. *See* Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939). In certain situations, such as when the corporation is insolvent, directors of a Delaware corporation also owe fiduciary duties to the creditors of the corporation. Adlerstein v. Wertheimer, No. 19101, 2002 WL 205684, at *11 (Del. Ch. Jan. 25, 2002). However, even when a corporation is insolvent, the directors must also fulfill their fiduciary duties to the stockholders and the corporate enterprise as a whole. *See id.* at *11; Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp., No. 12150, 1991 WL 277613, at *34 (Del. Ch. Dec. 30, 1991); Geyer v. Ingersoll Publ'ns Co., 621 A.2d 784, 789 (Del. Ch. 1992).

11. *Guth*, 5 A.2d at 510.

12. Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) ("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.") (citing Kaplan v. Centex Corp., 284 A.2d 119, 124 (Del. Ch. 1971)).

13. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993).

If the business judgment rule is rebutted by showing a breach of either the duty of care or the duty of loyalty, the board's action is reviewed using the entire fairness standard, and the directors bear the heavy burden of proving that the challenged decision or transaction is "entirely fair" to the corporation and its stockholders.[14] Under this more onerous standard, the board must "establish to the *court's* satisfaction that the transaction was the product of both fair dealing *and* fair price."[15] Although the application of the entire fairness standard is not necessarily outcome determinative,[16] the relative deference of the business judgment rule standard does provide directors with a significant incentive to ensure that the duties of care and loyalty are fulfilled when making corporate decisions.

A. Duty of Care

The duty of care requires that directors inform themselves "prior to making a business decision, of all material information reasonably available to them."[17] While the board must be reasonably informed, it is not required to be informed of every fact. Whether the board was informed of "all material information" is ultimately a question as to the quality of the information, the advice considered by the board, and whether the board had "sufficient opportunity to acquire knowledge concerning the problem before acting."[18] The duty of care also requires more than passive acceptance of information presented to the board; instead, directors must proceed with a "critical eye" in assessing information in order to protect the interests of the corporation and its stockholders.[19]

Determining directors' compliance with the duty of care is a fact specific inquiry. Factors considered by Delaware courts addressing this issue include whether directors (i) are supplied in advance with notice of

14. Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1162 (Del. 1995). Additionally, it is worth noting that "[f]rom a procedural perspective, the breach of any *one* of the board's fiduciary duties is enough to shift the burden of proof to the board to demonstrate entire fairness." *Id.* at 1164 (emphasis in original).

15. *Cede & Co.*, 634 A.2d at 361 (emphasis in original).

16. *See, e.g.*, S. Muoio & Co., LLC v. Hallmark Entm't Invs. Co., No. 4729-CC, 2011 WL 863007, at *21 (Del. Ch. Mar. 9, 2011) (finding that a transaction was entirely fair to the corporation and its stockholders); *In re* John Q. Hammons Hotels Inc. S'holder Litig., No. 758-CC, 2011 WL 227634, at *7 (Del. Ch. Jan. 14, 2011) (noting that the proposed transaction would have been upheld under entire fairness review).

17. Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (quoting *Aronson*, 473 A.2d at 812).

18. Moran v. Household Int'l, Inc., 490 A.2d 1059, 1075 (Del. Ch. 1985), *aff'd*, 500 A.2d 1346 (Del. 1985).

19. *See Van Gorkom*, 488 A.2d at 872.

the purpose of the meeting and documentation describing the essentials of the matters to be considered,[20] (ii) are informed of all developments relevant to the issue under consideration,[21] (iii) conduct extensive discussions with competent and independent legal and financial advisors,[22] (iv) review relevant or key documents or summaries thereof,[23] (v) make reasonable inquiry and receive a knowledgeable critique of the proposal,[24] and (vi) take sufficient time under the circumstances and act in a deliberative manner to consider and evaluate the pending decision.[25]

Delaware courts apply a "gross negligence" standard to determine whether a board has satisfied its duty of care when making a corporate decision.[26] In this context, Delaware courts have defined gross negligence as "'reckless indifference to or a deliberate disregard of the whole body of stockholders or actions which are without the bounds of reason.'"[27] The Court of Chancery has noted that "[t]hese articulations

20. *See id.* at 882-84.

21. *See id.* at 884-85.

22. *Compare* S. Muoio & Co. LLC v. Hallmark Entm't Invs. Co., No. 4729-CC, 2011 WL 863007, at *13-14 (Del. Ch. Mar. 9, 2011) (finding that a special committee had satisfied its duty of care when the committee members relied upon the opinions of financial advisors that were "selected with reasonable care," when the committee "reasonably believed that the task was within their professional or expert competence," and when the opinion was the result of "months of work and an understanding of the cable industry and [the company's] business"), *with In re* Loral Space & Commc's Inc. Consol. Litig., Nos. 2808-VCS, 3022-VCS, 2008 WL 4293781, at *23 (Del. Ch. Sept. 19, 2008) (criticizing a special committee that hired an "outgunned and outwitted" financial advisor that did nothing substantial to test the market for a transaction).

23. *See, e.g.*, *Van Gorkom*, 488 A.2d at 882-84 (criticizing a board of directors for approving amendments to a merger agreement "sight unseen"); *In re* Gaylord Container Corp. S'holders Litig., 753 A.2d 462, 479 n.57 (Del. Ch. 2000) ("[A]lthough it is hardly the most important factor supporting my decision, I believe that the board's reliance on a reputable law firm to advise it regarding its options supports a conclusion that the board acted on an informed basis.").

24. *See, e.g.*, Moran v. Household Int'l, Inc., 500 A.2d 1346, 1356 (Del. 1985). In *Moran*, the court noted that "[t]he extended discussion between the Board and [its legal and financial advisors] before approval of the [stockholder rights-plan] reflected a full and candid evaluation of the Plan. Moran's expression of his views at the meeting served to place before the Board a knowledgeable critique of the Plan." *Id.*

25. *Compare S. Muoio & Co.*, 2011 WL 863007, at *14 (commending the process of a special committee that met "twenty-nine times over a period of nine months" and that considered a variety of alternatives to the proposed transaction), *with* McMullin v. Beran, 765 A.2d 910, 921-22 (Del. 2000) (criticizing a board of directors for approving a significant corporate transaction after holding just one meeting to consider the issue and receiving a single presentation as to the material terms of the proposal).

26. *See Van Gorkom*, 488 A.2d at 873; *see also* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

27. Benihana of Tokyo, Inc. v. Benihana, Inc., 891 A.2d 150, 192 (Del. Ch. 2005) (quoting Tomczak v. Morton Thiokol, Inc., No. 7861, 1990 WL 42607, at *12 (Del. Ch. Apr. 5, 1990)).

arguably provide a higher threshold for liability than does the definition of gross negligence in general tort law."[28]

Delaware law permits a corporation to adopt a provision in its certificate of incorporation that exculpates the corporation's directors from monetary liability for breaches of the duty of care.[29] An exculpatory provision, however, does not shield directors from liability for claims related to breaches of the duty of loyalty or claims predicated on bad faith. Additionally, the adoption of such a provision does not give a director free reign to act without due care. Directors must still exercise due care in order for the board's decisions to be afforded business judgment rule deference, and extreme violations of the duty of care may be evidence of bad faith or may amount to a breach of the duty of loyalty to the corporation.[30]

B. Duty of Loyalty

Directors of Delaware corporations also owe a duty of loyalty to the corporation and its stockholders. Delaware courts have defined this duty of loyalty in broad and unyielding terms:

> Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. . . . A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers. The rule that

28. Rabkin v. Philip A. Hunt Chem. Corp., 547 A.2d 963, 970 (Del. Ch. 1986).

29. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2011). The Delaware legislature amended Section 102 of the General Corporation Law in 1986, in part, to address the concerns of directors following decisions of the Delaware Supreme Court in the mid-1980s holding directors liable for breaches of the duty of care (such as *Van Gorkom*) and the concomitant rise in the cost of directors' and officers' insurance. *See* Malpiede v. Townson, 780 A.2d 1075, 1095 (Del. 2001). For a more detailed discussion of Section 102(b)(7) and its effect on director liability, see 1 R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS § 4.13[B] (3d ed. 1998 & Supp. 2011) and 1 ERNEST L. FOLK ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 102.15 (5th ed. 2006 & Supp. 2011).

30. *See* BALOTTI & FINKELSTEIN, *supra* note 29, § 4.13[B]. *Cf. In re* Tyson Foods, Inc. Consol. S'holder Litig., 919 A.2d 563, 597-98 (Del. Ch. 2007).

> requires an undivided and unselfish loyalty to the corporation demands that there be no conflict between duty and self-interest.[31]

Thus, satisfying the duty of loyalty requires a director to put the interests of the corporation and its stockholders ahead of the director's own personal interests which are not shared by the stockholders generally.[32]

In general, the duty of loyalty means that directors of Delaware corporations may not (i) cause the corporation to engage in an interested transaction which is not entirely fair to the corporation;[33] (ii) profit from the use of confidential corporate information;[34] (iii) take any action solely or primarily to entrench themselves in office;[35] or (iv) otherwise place benefits to themselves or to affiliated entities ahead of benefits of the corporation.[36]

In order to satisfy the duty of loyalty, the board of directors must not have disabling conflicts of interest. In the event such conflicts do exist, the board must act proactively to properly insulate the decision-making process from those conflicts. A director may be considered interested where (i) the director is beholden to another party or has divided loyalties,[37] or (ii) the director will receive a benefit that is not shared by the corporation's stockholders as a whole.[38]

Where one or more directors are deemed to be interested, the board risks losing the presumption of the business judgment rule. The board's decision will not receive the benefit of deference under the business judgment rule where self-interested directors constitute or meet any of

31. Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

32. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993).

33. An "interested transaction" is a transaction in which one or more directors approving the transaction receives a benefit (whether financial or otherwise) that is (i) not shared by the stockholders of the corporation as whole and (ii) subjectively material to that director's decision to approve the transaction. *See* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1167-68 (Del. 1995); *Cede & Co*., 634 A.2d at 362-63.

34. *See, e.g.*, Brophy v. Cities Serv. Co., 70 A.2d 5, 7-8 (Del. Ch. 1949) ("A fiduciary is subject to a duty to the beneficiary not to use on his own account information confidentially given him by the beneficiary or acquired by him during the course of or on account of the fiduciary relation or in violation of his duties as fiduciary, in competition with or to the injury of the beneficiary . . . unless the information is a matter of general knowledge.").

35. *See* Polk v. Good, 507 A.2d 531, 536-37 (Del. 1986); Unocal v. Mesa Petroleum, 493 A.2d 946, 954-56 (Del. 1985).

36. *See, e.g.*, Gantler v. Stephens, 965 A.2d 695, 706-08 (Del. 2009); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

37. *See, e.g.*, *In re* Primedia Inc. Derivative Litig., 910 A.2d 248, 256-57 (Del. Ch. 2006); *In re* Emerging Commc'ns, Inc. S'holders Litig., No. 16415, 2004 WL 1305745, at *33-35 (Del. Ch. May 3, 2004).

38. *See, e.g.*, Gantler v. Stephens, 965 A.2d 695, 706-08 (Del. 2009); *Aronson*, 473 A.2d at 812.

the following conditions: (i) a majority of the board;[39] (ii) control or domination of the board as a whole;[40] or (iii) a failure to disclose their interest in the transaction to the whole board, an interest which a reasonable board member would regard as having a significant effect on those directors' evaluation of the transaction.[41] If the business judgment rule presumption is lost, the board will be required to demonstrate that the challenged transaction or decision was entirely fair to the corporation and its stockholders.[42]

In the context of a merger, a board should consider taking affirmative steps to minimize potential conflicts of interest. Directors with potential conflicts of interest should consider recusing themselves from discussing and voting on potentially interested transactions.[43] The board of directors should also retain independent advisors (including investment bankers and special Delaware counsel) to assist the board in considering potentially conflicting transactions.[44] Managers may need to be excluded from pivotal decision-making meetings if those managers will be participating in the post-merger entity (including managers who also serve as directors). Managers should also refrain from negotiating or otherwise discussing employment in the post-merger entity until after the parties have reached an agreement on price and the material terms of the merger agreement, and the independent directors should be asked to

39. *See In re* INFOUSA, Inc. S'holders Litig., 953 A.2d 963, 989-90 (Del. Ch. 2007). *Cf.* Benihana of Tokyo, Inc. v. Benihana, Inc., 891 A.2d 150, 192 (Del. Ch. 2005) (finding no breach of the duty of loyalty when an action allegedly taken with the primary purpose of entrenchment was approved by a majority of the disinterested board members); Orban v. Field, No. 12820, 1997 WL 153831, at *10 (Del. Ch. Apr. 1, 1997) (holding that a "payment decision . . . approved by a majority of disinterested directors [and one interested director] is entitled to the protection of the business judgment rule"). Delaware courts generally do not consider a director's ownership of the corporation's stock to be a disabling financial interest because it "align[s] the interests of the . . . directors with the common stockholders and give[s] them a personal incentive to fulfill their duties effectively." LC Capital Master Fund, Ltd. v. James, 990 A.2d 435, 452 (Del. Ch. 2010). *See Aronson*, 473 A.2d at 812-13.

40. Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156, 1168 (Del. 1995).

41. *Id.* *See Benihana*, 891 A.2d at 180-81 ("[The duty of loyalty] requires directors to take affirmative steps to disclose any interest they may have in a transaction.").

42. *Cinerama*, 663 A.2d at 1168 (Del. 1995); Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983); *In re* S. Peru Copper Corp. S'holders Litig., No. 961-CS, 2011 WL 6440761, at *19-20 (Del. Ch. Oct. 14, 2011).

43. Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1343 (Del. 1987) (finding that the recusal of two interested directors "materially enhanced" the proof that a board had acted in good faith).

44. Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1282 (Del. 1988) (stating that "without board planning and oversight . . . to ensure the proper conduct of the auction by truly independent advisors selected by, and answerable only to, the independent directors, the legal complications which a challenged transaction faces . . . are unnecessarily intensified").

review and approve any employment agreements that are reached.[45] In circumstances where conflicts of interest cannot be avoided (such as in transactions involving controlling stockholders), boards should consider forming special committees of independent and disinterested directors to consider and negotiate the transactions on behalf of the corporation.[46]

C. *Additional Duties of Directors Derived from the Duties of Care and Loyalty*

1. Duty of Good Faith

The duty of loyalty includes a director's obligation to act in good faith. Although the duty of good faith was once considered a free-standing duty under Delaware law,[47] more recent decisions treat the concept of good faith as a part of the duty of loyalty.[48] A director violates the duty of good faith when that director

> intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.[49]

A breach of the duty of good faith "'requires a showing that the directors knew that they were not discharging their fiduciary obligations.'"[50]

2. Duty of Confidentiality

The duty of loyalty also implies that directors have a duty to keep corporate information confidential. This duty of confidentiality means that directors may not use confidential corporate information to further

45. *See* Wayne Cnty. Emps.' Ret. Sys. v. Corti, No. 3534-CC, 2009 WL 2219260, at *11-12 (Del. Ch. July 24, 2009).

46. *See, e.g.*, *Weinberger*, 457 A.2d at 709 n.7 (noting that forming a special committee to consider a proposal would have been an indication of arms-length dealing).

47. Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993) (stating that "to rebut the [business judgment] rule, a shareholder plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decision, breached any one of the *triads* of their fiduciary duty—good faith, loyalty or due care") (emphasis in original).

48. *See* Stone *ex rel.* AmSouth Bancorp. v. Ritter, 911 A.2d 362, 369-70 (Del. 2006) ("[T]he obligation to act in good faith does not establish an independent fiduciary duty that stands on the same footing as the duties of care and loyalty. Only the latter two duties, where violated, may directly result in liability, whereas a failure to act in good faith may do so, but indirectly.").

49. *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 67 (Del. 2006).

50. Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 240 (Del. 2009) (quoting *Stone*, 911 A.2d at 370).

their own interests and may not disclose confidential corporate information to others who can use that information to their own benefit.[51] The duty of confidentiality also extends to the boardroom deliberations of directors.[52] In the context of a merger transaction, the duty of confidentiality is particularly significant as directors often deal with sensitive or nonpublic corporate information. Improper disclosure of this information to stockholders or third parties that is detrimental to the corporation or improperly beneficial to the director will constitute a breach of the director's duty of loyalty.[53]

3. Duty of Disclosure

The duty of disclosure requires directors to act with "complete candor;" in certain circumstances, this duty also necessitates full disclosure to the corporation's stockholders of "all of the facts and circumstances" relevant to the board's decision.[54] Like the duty of good faith, the duty of disclosure is not considered to be a free-standing duty under Delaware law, but is instead viewed as being derived from the duties of care and loyalty.[55] In the context of negotiating merger transactions, directors owe a duty of disclosure to the corporation's stockholders because most enterprise-level transactions will ultimately require stockholder approval under Delaware law.[56] When a transaction

51. *See* Brophy v. Cities Serv. Co., 70 A.2d 5, 7-8 (Del. Ch. 1949) ("A fiduciary is subject to a duty to the beneficiary not to use on his own account information confidentially given him by the beneficiary . . . in competition with or to the injury of the beneficiary."); *see also* Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) (noting that the duty of confidentiality "does not rest upon the narrow ground of injury or damage to the corporation resulting from a betrayal of confidence, but upon a broader foundation of a wise public policy that, for the purpose of removing all temptation, extinguishes all possibility of profit flowing from a breach of the confidence imposed by the fiduciary relation").

52. *See* Disney v. Walt Disney Co., No. 234-N, 2005 WL 1538336, at *4 (Del. Ch. June 20, 2005) (noting that "[t]he preliminary deliberations of a corporate board of directors generally are non-public and should enjoy 'a reasonable expectation that they [will] remain private'").

53. *See, e.g.*, *In re* MCA, Inc. S'holders Litig., 598 A.2d 687, 694 (Del. Ch. 1991) (stating that "[i]t is when the director uses inside information for his own benefit that he has abused his office and thus breached his duty of loyalty").

54. Lynch v. Vickers Energy Corp., 383 A.2d 278, 279 (Del. 1977).

55. Malpiede v. Townson, 780 A.2d 1075, 1086 (Del. 2001) (observing that "the board's fiduciary duty of disclosure . . . is not an independent dut[y] but the application in a specific context of the board's fiduciary duties of care . . . and loyalty").

56. *See, e.g.*, DEL. CODE ANN. tit. 8, § 251 (West 2010) (requiring stockholder approval of a merger); *id.* § 271 (requiring stockholder approval of the sale of all or substantially all of a corporation's assets); *id.* § 275 (requiring stockholder approval of the dissolution of a corporation).

requires stockholder approval, the board "is under a duty to disclose fully and fairly pertinent information within the board's control."[57]

Delaware law employs a materiality standard in order to assess whether information must be disclosed. Under this standard, "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."[58] Therefore, directors involved in a merger transaction must be prepared to disclose all relevant information related to their consideration of that transaction (including the existence of and specifics related to alternative offers and the board of director's response to such offers) in order to enable the stockholders to make fully informed decisions.

III. DIRECTORS' DUTIES IN CONSIDERING AN M&A TRANSACTION

The previous Section discussed the fiduciary duties of directors generally. This Section reviews the fiduciary duties of directors in the specific context of considering the sale of a corporation, whether by a merger or by another transaction.

This Section proceeds in three parts. Part A discusses whether directors ever have an affirmative duty to consider, enter into negotiations with respect to, or defend against an unsolicited acquisition proposal. Part B discusses *Revlon* duties and the *Revlon* standard of review: more specifically, the duties of directors in considering certain sale transactions and the standard a court will apply in reviewing compliance with those duties, each taking its name from the seminal case on the topic, *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc*.[59] Finally, Part C discusses when a corporation is "up for sale" such that *Revlon* applies.

A. *Consideration of an Unsolicited Acquisition Proposal*

It is quite common—especially in today's market where the efficient-market hypothesis is being tested with each rollercoaster swing of the Dow—for a fundamentally sound corporation to receive an unsolicited acquisition proposal. The current state of Delaware law with respect to responding to such a proposal appears to be as follows: (i) directors should inform themselves prior to deciding how (if at all) to

57. Stroud v. Milliken Enters., Inc., 552 A.2d 476, 480 (Del. 1989) (internal quotation omitted); *see also* Rosenblatt v. Getty Oil Co., 493 A.2d 929, 944-45 (Del. 1985); Smith v. Van Gorkom, 488 A.2d 858, 890 (Del. 1985); Lacos Land Co. v. Arden Grp., Inc., 517 A.2d 271, 279 (Del. Ch. 1986).

58. *Rosenblatt*, 493 A.2d at 944 (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

59. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

respond to unsolicited acquisition proposals; (ii) directors need not negotiate with respect to, nor seek alternatives to, unsolicited acquisition proposals; and (iii) directors may have a duty to defend against unsolicited acquisition proposals.

1. Directors Should Inform Themselves Prior to Deciding How (If at All) to Respond to an Unsolicited Acquisition Proposal

To meet their duty of care, directors should inform themselves prior to deciding how (if at all) to respond to unsolicited acquisition proposals. For example, in *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*,[60] the Court of Chancery observed that although a "target can refuse to negotiate," the target "should be informed when making such [a] refusal."[61] In other words, "[e]ven the decision not to negotiate . . . must be an informed one."[62] A board that refuses to become informed about an acquisition proposal engages in "willful blindness, a blindness that may constitute a breach of the board's duty of care."[63]

2. Directors Need Not Negotiate with Respect to, Nor Seek Alternatives to, an Unsolicited Acquisition Proposal

Once directors become informed with respect to an unsolicited acquisition proposal, they may decide that pursuing the proposal, or other alternatives, is not in the best interest of the corporation and its stockholders. Delaware law provides that if a disinterested and independent board makes such a decision in good faith, its decision generally will be protected by the presumption of the business judgment rule. Thus, for example, in *Lyondell Chem. Co. v. Ryan*,[64] a potential acquiring party filed a Schedule 13D with the United States Securities and Exchange Commission in May 2007, disclosing a right to acquire an 8.3% block of Lyondell and also disclosing the acquiring party's interest in a possible transaction with Lyondell.[65] Although recognizing that the

60. Phelps Dodge Corp. v. Cyprus Amax Minerals Co., Nos. 17398, 17383, 17427, 1999 WL 1054255 (Del. Ch. Sept. 27, 1999).
61. *Id.* at *1.
62. *Id.*
63. *Id.* at *2; *see also* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1154 (Del. 1990) ("Time's failure to negotiate cannot be fairly found to have been uninformed."); *In re* IXC Commc'ns, Inc. S'holders Litig., Nos. 17324, 17334, 1999 WL 1009174, at *5 (Del. Ch. Oct. 27, 1999) (rejecting stockholder-plaintiffs' claim that directors breached their duty of care by failing to inform themselves before turning down offers from potential suitors when record showed directors pursued every expression of interest before exercising their best judgment as to which offers merited serious consideration and which offers should not be further explored).
64. Lyondell Chem. Co. v. Ryan, 970 A.2d 235 (Del. 2009).
65. *Id.* at 237.

Schedule 13D "signaled to the market that the company was 'in play,'" Lyondell's board of directors was not subject to heightened *Revlon* duties until it decided to negotiate with the acquiring party two months later.[66] The Delaware Supreme Court's analysis in *Lyondell* is instructive:

> *Revlon* duties do not arise simply because a company is "in play." The duty to seek the best available price applies only when a company embarks on a transaction—on its own initiative or in response to an unsolicited offer—that will result in a change of control. [The acquiror's] Schedule 13D did put the Lyondell directors, and the market in general, on notice that [the acquiror] was interested in acquiring Lyondell. The directors responded by promptly holding a special meeting to consider whether Lyondell should take any action. The directors decided that they would neither put the company up for sale nor institute defensive measures to fend off a possible hostile offer. Instead, they decided to take a "wait and see" approach. *That decision was an entirely appropriate exercise of the directors' business judgment.* The time for action under *Revlon* did not begin until July 10, 2007, when the directors began negotiating the sale of Lyondell.[67]

3. Directors May Have a Duty to Defend against an Unsolicited Acquisition Proposal

In its landmark 1985 opinion *Unocal Corp. v. Mesa Petrol. Co.*,[68] the Delaware Supreme Court held that directors have a "fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source."[69] This fundamental duty applies even in the context of third-party tender offers made directly to stockholders, where the General Corporation Law does not expressly contemplate a role for target boards.[70]

In the early part of last decade, the Court of Chancery expressed reluctance to find that the affirmative duty to protect the corporate

66. *Id.* at 237, 242.

67. *Id*. at 242 (emphasis added) (citations omitted); *see also* Kahn v. MSB Bancorp, Inc., No. 14712-NC, 1998 WL 409355, at *3 (Del. Ch. July 16, 1998) (holding that the business judgment presumption applied to a board's decision to reject an unsolicited acquisition proposal because Section 251 of the General Corporation Law implicitly recognizes that the board may decline to enter into a merger); TW Servs., Inc. v. SWT Acquisition Corp., Nos. 10427, 10298, 1989 WL 20290, at *11 (Del. Ch. Mar. 2, 1989).

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

69. *Id.* at 945.

70. *See In re* Pure Res., Inc. S'holders Litig., 808 A.2d 421, 439-40 (Del. Ch. 2002) (citing *Unocal* in observing that a target board may impede "the consummation of a tender offer through extraordinary defensive measures, such as a poison pill").

enterprise discussed in *Unocal* compelled the use of a "poison pill" in response to an unsolicited acquisition proposal.[71] In 2009, however, the Court of Chancery signaled an intention to revisit the issue when it declined to dismiss allegations that directors had breached their fiduciary duties when they failed to enact a poison pill to prevent a stockholder from engaging in a "creeping takeover" of the company through open market purchases.[72]

Thus, the law is currently in a state of flux as to what actions directors *must* take to protect stockholders, either while considering an unsolicited acquisition proposal, or in response to an unsolicited acquisition proposal that the directors have determined to be inadequate. Therefore, it is prudent for directors to at least consider whether it would be in the best interests of the corporation and its stockholders to adopt defensive measures when considering the corporation's overall response to unsolicited acquisition proposals.

B. Revlon Duties and the Revlon Standard of Review

When directors put a corporation "up for sale" (including in response to an unsolicited acquisition proposal), their duty changes "from the preservation of [the company] as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit."[73] The Delaware Supreme Court has identified three circumstances in which a corporation is considered "up for sale" such that a change of duty is implicated (i) when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company,[74] (ii) when, in

71. *See id.* at 446; *see also infra* Part IV.C.2 (providing additional background and guidance regarding the implementation, use, and redemption of poison pills).

72. La. Mun. Police Emps. Ret. Sys. v. Fertitta, No. 4339-VCL, 2009 WL 2263406, at *8 n.34 (Del. Ch. July 28, 2009) ("To say that there is no *per se* duty to employ a poison pill to block a 46% stockholder from engaging in a creeping takeover does not refute the conclusion that the board's failure to employ a pill, together with other suspect conduct, supports a reasonable inference at the motion to dismiss stage that the board breached its duty of loyalty in permitting the creeping takeover."); *see In re* CNX Gas Corp. S'holders Litig., 4 A.3d 397, 415 (Del. Ch. 2010) (suggesting that a board committee designated to consider a going-private proposal from a controlling stockholder be given the power to enact a poison pill).

73. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986).

74. That said, considering, but not effecting, a change of control is not necessarily considered putting a company up for sale. *See, e.g.*, Arnold v. Soc'y for Sav. Bancorp, Inc., 650 A.2d 1270, 1290 (Del. 1994) (finding that, although the market was initially canvassed for potential acquirors of the whole company, *Revlon* was not implicated because the board did not initiate an active bidding process and the resulting transaction did not involve a change in control); Wells Fargo & Co. v. First Interstate Bancorp, Nos. 14696, 14623, 1996 WL 32169, at *4 (Del. Ch. Jan. 18, 1996) ("[T]he fact that [a target]

response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the break-up of the company, or (iii) when approval of a transaction results in a sale or change of control.[75]

1. Effects of *Revlon*

There are three important implications for directors finding themselves in circumstances where *Revlon* applies.

First, the directors no longer may consider long-term value; rather, the directors' duty is "to get the best short-term price for stockholders."[76] Thus, the directors' focus ought to be on the value target stockholders receive at the closing of the transaction, and not the potential increase in value of the surviving entity in the months and years after closing.[77] Importantly, however, *Revlon* does not require that directors take the highest bid; rather, it requires directors to take the highest bid reasonably available.[78]

Second, "A board's duty to be informed" when *Revlon* applies "will require it to fully consider alternative transactions offered by any responsible buyer."[79] Thus, if the corporation receives an unsolicited acquisition proposal in a *Revlon* context, the directors have a duty to

board talked to a number of other possible transaction-partners does not itself constrain the usual scope of board authority and does not invoke . . . special duties.").

75. *Arnold*, 650 A.2d at 1290 (internal citations and quotation marks omitted).

76. *In re* MONY Grp. Inc. S'holder Litig., 852 A.2d 9, 19 (Del. Ch. 2004); *see also* Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1280 (Del. 1989) (stating that under *Revlon*, in the context of the sale of corporate control, the responsibility of directors is to get the highest value reasonably attainable for the stockholders); Krim v. ProNet, Inc., 744 A.2d 523, 527 (Del. 1999).

77. *See* Paramount Commc'ns, Inc. v. QVC Network Inc., 637 A.2d 34, 50 (Del. 1994) (stating that a vision for the future cannot justify a significant disparity of current value).

78. *See In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 602 (Del. Ch. 2010) (refusing to grant a preliminary injunction against a transaction, even though a competing bidder had submitted an indication of interest with a higher price, when the competing bidder faced antitrust and financing constraints and refused to agree to a reverse termination fee); Golden Cycle, LLC v. Allen, No. 16301, 1998 WL 892631, at *15 (Del. Ch. Dec. 10, 1998) (denying preliminary injunction where directors rejected higher bid because it contained numerous conditions and bidder refused to execute confidentiality agreement); Transcript of Ruling of the Court at 6-7, Malpiede v. Townson, Nos. 15943, 15944, 15946 (Del. Ch. Sept. 29, 1997) ("[R]ules of the game are not that the highest offer always wins no matter what the circumstances. This Court will intervene, but only if there is some showing measured by some appropriate evidentiary standard that the lower price was the product of a breach of fiduciary duty. It will not intervene if the price is merely the product of a complex business judgment which itself was the product of highly unusual circumstances.").

79. *Wells Fargo*, 1996 WL 32169, at *11 n.3.

fully investigate the offer and determine whether it may result in a better value to the corporation's stockholders than an existing offer.

Third, the standard of review in determining whether directors have acted in conformity with their fiduciary duties is heightened when *Revlon* applies, such that "the directors have the burden of proving that they were adequately informed and acted reasonably."[80] "Unlike the bare rationality standard applicable to garden-variety decisions subject to the business judgment rule, the *Revlon* standard contemplates a judicial examination of the reasonableness of the board's decision-making process."[81] In an oft-cited statement of the standard of review when *Revlon* applies, the Delaware Supreme Court observed as follows:

There are many business and financial considerations implicated in investigating and selecting the best value reasonably available. The board of directors is the corporate decisionmaking body best equipped to make these judgments. Accordingly, a court applying enhanced judicial scrutiny should be deciding whether the directors made *a reasonable* decision, not *a perfect* decision. If a board selected one of several reasonable alternatives, a court should not second-guess that choice even though it might have decided otherwise or subsequent events may have cast doubt on the board's determination.[82]

2. Complying with *Revlon* Duties

There is no single blueprint that directors must follow in order to fulfill their *Revlon* duties.[83] In other words, "*Revlon* does not proscribe any specific steps that must be taken by a board before selling control of the corporation."[84] Whether a particular technique is acceptable depends on the specific circumstances in which the directors' *Revlon* duties arose.[85] One method by which directors have fulfilled their *Revlon*

80. *QVC Network Inc.*, 637 A.2d at 45.

81. *In re* Netsmart Techs., Inc. S'holders Litig., 924 A.2d 171, 192 (Del. Ch. 2007).

82. *QVC Network Inc.*, 637 A.2d at 45 (emphasis in original); *see In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1000 (Del. Ch. 2005) ("Critically, in the wake of *Revlon*, Delaware courts have made clear that the enhanced judicial review *Revlon* requires is not a license for law-trained courts to second-guess reasonable, but debatable, tactical choices that directors have made in good faith.").

83. *See* Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989).

84. Wayne Cnty. Emps. Ret. Sys. v. Corti, No. 3534-CC, 2009 WL 2219260, at *15 (Del. Ch. July 24, 2009).

85. *See* Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 242 (Del. 2009) ("No court can tell directors exactly how to . . . [satisfy their *Revlon* duties], because they will be facing a unique combination of circumstances, many of which will be outside their control."); *In re Netsmart*, 924 A.2d at 197 (Del. Ch. 2007) ("The 'no single blueprint' mantra is not a one way principle. The mere fact that a technique was used in different market circumstances by another board and approved by the court does not mean that it is reasonable in other circumstances that involve very different market dynamics.").

duties is soliciting bids from potential buyers before signing a merger agreement.[86] However, it is not always necessary that the board engage in pre-signing solicitations or a public auction of the company.[87] It is possible for an initial bid to be so good as to preempt any subsequent bids. In such a case, directors may satisfy their *Revlon* duties by accepting the initial bid.[88] In addition, the Delaware Supreme Court has expressly held that directors may also satisfy their *Revlon* duties by selecting a bidder, entering into a transaction with that bidder, and testing the transaction with a post-signing market check.[89] A post-signing market check often takes the form of a "go-shop" provision in a merger agreement, which allows the target company to affirmatively contact potential acquiring companies for a specified period of time after the parties sign the merger agreement.[90]

At bottom, what are considered "reasonable" actions designed to achieve the highest short-term value reasonably available vary with the

86. *See, e.g.*, *In re* Answers Corp. S'holders Litig., No. 6170-VCN, 2011 WL 1366780, at *4 (Del. Ch. Apr. 11, 2011) (holding that directors complied with their fiduciary duties by discreetly soliciting ten "priority potential buyers" the board identified as most likely to be interested in purchasing the company); *In re* Orchid Cellmark Inc. S'holder Litig., No. 6373-VCN, 2011 WL 1938253, at *5 (Del. Ch. May 12, 2011) (holding that directors complied with their *Revlon* duties by contacting six potential bidders over the course of six weeks after receiving an initial unsolicited bid).

87. Freedman v. Rest. Assocs. Indus., Inc., No. 9212, 1990 WL 135923, at *5 (Del. Ch. Sept. 19, 1990) ("Although a board of directors may fulfill its obligation to make an informed and reasonable business judgment in a sale context by conducting an auction sale . . . an auction is not always necessary.").

88. *See Barkan*, 567 A.2d at 1287 (holding that when "directors possess a body of reliable evidence with which to evaluate the fairness of a transaction, they may approve that transaction without conducting an active survey of the market").

89. *See Lyondell*, 970 A.2d at 243; *see also In re* MONY Grp. Inc. S'holder Litig., 852 A.2d 9, 20-24 (Del. Ch. 2004) (holding that a board's decision to limit merger negotiations to one bidder and to rely on a five month, post-signing market check complied with *Revlon*); *In re* Pennaco Energy, Inc. S'holders Litig., 787 A.2d 691, 705-07 (Del. Ch. 2001) (finding that the board met *Revlon* duties by aggressively negotiating with single bidder and ensuring merger agreement did not contain onerous deal protection measures that would impede a topping bid); *In re* Fort Howard Corp. S'holders Litig., No. 9991, 1988 WL 83147, at *12-13 (Del. Ch. Aug. 8, 1988) (finding that a special committee of independent directors did not conduct a pre-signing market check but nevertheless fulfilled *Revlon* duties by negotiating merger agreement provisions intended to permit an effective check of the market before the closing of the transaction).

90. *See, e.g.*, *In re* Lear Corp. S'holder Litig., 926 A.2d 94, 118-20 (Del. Ch. 2007) (finding that the board complied with *Revlon* duties by foregoing a broad pre-signing auction process and instead entering into a merger agreement providing for a 45-day go-shop period); *In re* Topps Co. S'holders Litig., 926 A.2d 58, 84-87 (Del. Ch. 2007) (finding that the board complied with *Revlon* duties by accepting a "bird-in-hand" proposal that permitted a 40-day go-shop period when the board reasonably concluded that an auction process would not result in a more attractive proposal, the bird-in-hand suitor indicated that it would withdraw its offer if an auction commenced, and the board had legitimate concerns about the negative effect on the company of a failed auction).

circumstances. The Delaware courts have accordingly been reluctant to interfere with informed decisions of disinterested, independent boards or to prescribe precise techniques for directors to follow in order to fulfill their *Revlon* duties.

C. *When Is a Corporation "Up For Sale" Such that* Revlon *Applies?*

Not all takeovers involve sales of control. As recently recognized by the Court of Chancery, "a question of much ongoing debate . . . is when does a corporation enter *Revlon* mode such that its directors must act reasonably to maximize short-term value of the corporation for its stockholders."[91] *Revlon* itself demonstrates that a cash-out merger with a third party generally triggers *Revlon* duties. This subsection discusses three fact patterns that are less clear.

1. Cash Out Merger with a Controlling Stockholder

A controlling stockholder has the right to control and vote its shares in its own interest.[92] Thus, a controlling stockholder has the ability, by virtue of its stock ownership, to veto any proposed sales transaction. Accordingly, if a controlling stockholder has informed the target board that it will exercise its effective veto right in order to prevent any sale of the target other than a proposed cash-out of minority stockholders by the controlling stockholder, *Revlon* will not impose on the target directors the obligation to do the impossible: to search for an alternative to the controlling stockholder's proposed cash-out.[93] Instead, in such a circumstance, the directors' "duty to 'obtain the greatest value reasonably attainable' for the public shareholders means . . . the greatest value reasonably attainable from the controlling stockholder, in accordance with the entire fairness standard."[94]

91. *In re* Smurfit-Stone Container Corp. S'holder Litig., No. 6164-VCP, 2011 WL 2028076, at *12 (Del. Ch. May 20, 2011).

92. Bershad v. Curtiss-Wright Corp., 535 A.2d 840, 845 (Del. 1987).

93. *Id.* at 844-45. In Mendel v. Carroll, 651 A.2d 297 (Del. Ch. 1994), the Court of Chancery observed that, as a general matter, directors should not dilute a controlling stockholder in order to facilitate an offer from a third party that is higher than the controlling stockholder's offer. *Mendel*, 651 A.2d at 306. The court did acknowledge, however, that circumstances could exist where the general rule gives way, specifically identifying a scenario in which directors determine in good faith that such dilution is necessary "to protect the corporation or its minority shareholders from exploitation by a controlling shareholder who was in the process or threatening to violate his fiduciary duties to the corporation[.]" *Id.*

94. *In re* Best Lock Corp. S'holder Litig., 845 A.2d 1057, 1091 n.139 (Del. Ch. 2001).

2. Sale of a Controlled Corporation

In contrast to a cash-out merger with a controlling stockholder that has indicated it will not sell its stake to a third party, the sale of a company to a third party proposed by a controlling stockholder, by definition, involves the controlling stockholder selling its stake. Where a subsidiary board "under[takes] to find a buyer for the whole enterprise" at the suggestion of its controlling stockholder, that board is "charged with getting the maximum value reasonably attainable for the stockholders;" in other words, *Revlon* duties apply.[95] However, the Delaware Supreme Court has recognized the reality that "[w]hen the entire sale to a third-party is proposed, negotiated and timed by a majority shareholder . . . the board cannot realistically seek any alternative because the majority shareholder has the right to vote its shares in favor of the third-party transaction it proposed for the board's consideration."[96] Thus, the Delaware Supreme Court has held that although *Revlon* applies in the sale of a controlled corporation proposed, negotiated, and timed by a majority stockholder, the duty of directors in such a circumstance is "to make an informed and deliberate judgment, in good faith, about whether the sale to a third party that is being proposed by the majority shareholder will result in a maximization of value for the minority shareholders."[97] In doing so, the directors must determine whether the proposed merger consideration "equal[s] or exceed[s] [the target's] appraisal value as a going concern."[98]

3. Stock-For-Stock Merger

"[P]ure stock-for-stock transactions do not necessarily trigger *Revlon*."[99] When both before and after a transaction control of a corporation exists "in a fluid aggregation of unaffiliated shareholders representing a voting majority," *Revlon* does not apply.[100] In other

95. *In re* CompuCom Sys., Inc. Stockholders Litig., No. 499-N, 2005 WL 2481325, at *5 (Del. Ch. Sept. 28, 2005).
96. McMullin v. Beran, 765 A.2d 910, 918-19 (Del. 2000).
97. *Id.*
98. *Id.* at 922. *But cf. In re* Paxson Commc'n Corp. S'holders Litig., No. 17568, 2001 WL 812028, at *7 (Del. Ch. July 10, 2001) (holding that the duty to maximize stockholder value was not triggered where majority stockholder that owned 75% of the company's voting power gave a call right to a third party, because either the majority stockholder or holder of the call right retained control of the company and the minority stockholders would never be in the position to collectively control the company and receive a control premium for their shares).
99. *In re Smurfit-Stone Container Corp.*, S'holder Litig., No. 6164-VCP, 2011 WL 2028076, at *12 (Del. Ch. May 20, 2011).
100. Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150 (Del. 1989).

words, when the acquiror in a stock-for-stock merger does not have a controlling stockholder, *Revlon* generally should not apply, because in such a merger, "the target's stockholders' voting power will not be diminished to minority status and they are not foreclosed from an opportunity to obtain a control premium in a future change of control transaction involving the resulting entity."[101] Where, however, "the resulting entity has a controlling stockholder or stockholder group such that the target's stockholders are relegated to minority status in the combined entity, Delaware Courts have found a change of control would occur for *Revlon* purposes."[102] This is so because in such a merger, the target stockholders "will have no leverage in the future to demand another control premium."[103]

But what of a merger in which target stockholders receive a mix of cash and stock in a non-controlled company? On the one hand, target stockholders will retain some ability to obtain a control premium for their shares in the future. On the other hand, certain of the target stockholders' shares will be cashed out. The three key Delaware cases that have directly addressed the issue seem to have been decided based upon the split in percentage of cash and stock. For example, in *In re Santa Fe Pac. Corp. S'holder Litig.*,[104] the Delaware Supreme Court found that a transaction with a voluntary 33% cash component did not necessarily implicate *Revlon*.[105] In *In re Lukens Inc. S'holders Litig.*,[106] however, the Court of Chancery suggested that a transaction in which over 60% of the consideration is cash implicated *Revlon*.[107] Lastly, in *In re Smurfit-Stone Container Corp. S'holder Litig.*,[108] the Court of Chancery held that a transaction involving approximately 50% cash consideration implicated *Revlon*.[109]

101. *In re Smurfit-Stone*, 2011 WL 2028076, at *12. One Vice Chancellor has suggested that in any "final stage" transaction—regardless of whether stockholders retain the ability to get "a future control premium"—enhanced scrutiny should apply because "what you're bargaining over" in a stock-for-stock sale "is how much of that future premium you're going to get." Transcript of Ruling of the Court at 4-5, Steinhardt v. Howard-Anderson, No. 5878-VCL (Del. Ch. Jan. 24, 2011), Entry No. 45602445. *See also* Reis v. Hazelett Strip-Casting Corp., 28 A.3d 442, 458 (Del. Ch. 2011) ("Final stage transactions for stockholders provide another situation where enhanced scrutiny applies.").

102. *In re Smurfit-Stone*, 2011 WL 2028076, at *12 (quoting Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 42-43 (Del. 1994)).

103. *QVC Network Inc.*, 637 A.2d at 43.

104. *In re* Santa Fe Pac. Corp. S'holders Litig., 669 A.2d 59 (Del. 1995).

105. *Id.* at 70-71.

106. *In re* Lukens, Inc. S'holders Litig., 757 A.2d 720 (Del. Ch. 1999).

107. *Id.* at 737-38.

108. In re Smurfit-Stone Container Corp. S'holder Litig., No. 6164-VCP, 2011 WL 2028076 (Del. Ch. May 20, 2011).

109. *See generally id.*

IV. FIDUCIARY DUTIES OF DIRECTORS OF DELAWARE CORPORATIONS IN CONNECTION WITH THE APPROVAL OF DEFENSIVE MEASURES

Directors of Delaware corporations may be asked to consider the approval of protective or defensive measures in connection with proposed business transactions. Where a board takes steps to (i) lock-up or secure a favored transaction or (ii) fend off or thwart unwanted suitors or defend against a disfavored transaction, such defensive actions will likely be subjected to heightened judicial scrutiny in the event of litigation challenging their validity, even if the majority of the board is comprised of independent directors. Although considerably less rigorous than the entire fairness standard of review that attends the approval of interested transactions of any stripe, this enhanced level of judicial examination is far more taxing than that of the deferential business judgment rule that insulates from judicial second-guessing even the most egregiously mistaken board decisions so long as they are made carefully, objectively, and in good faith. As a result, the board's decision to implement protective or defensive measures will not be accorded the threshold procedural presumptions of validity that would otherwise apply to board decisions. Nonetheless, so long as the board can establish that the approved actions are neither preclusive nor coercive in nature and that they constitute a reasonable and proportionate response to a reasonably perceived threat to the corporation or its stockholders, they will not be judicially invalidated.

A. *Enhanced Scrutiny under* Unocal *and Its Progeny*

Under the enhanced scrutiny standard of judicial review first articulated by the Delaware Supreme Court in *Unocal Corp. v. Mesa Petrol. Co.*,[110] a board's adoption of a defensive measure will be insulated from judicial invalidation without regard for its ultimate effectiveness as long as the following conditions are satisfied: (i) the board had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed," and (ii) the "defensive response was reasonable in relation to the threat posed."[111] Delaware law applies this enhanced standard of review in the defensive context even when the challenged decision has been made by an independent board in recognition of "the omnipresent specter that a board may be acting primarily in its own interests" in perpetuating its own incumbency in

110. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).
111. *See* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1373 (Del. 1995) (citing *Unocal*, 493 A.2d at 955).

defending against a would-be acquiror.[112] Enhanced scrutiny is often characterized as an "intermediate" level of review,[113] falling between the broadly deferential business judgment standard and the rigorous review required by the entire fairness standard. Though it effectively operates as a threshold procedural determination as to whether the board has or has not established the reasonableness and proportionality of its actions, it has been observed that the result of the application of this preliminary test is often outcome determinative, meaning that satisfying the court of the reasonableness of the board's actions in response to this threshold inquiry leaves little basis for reversal or invalidation of the decision upon the completion of the mandated judicial analysis.[114]

The heightened level of judicial scrutiny mandated by the *Unocal* standard entails an atypically thorough review of the board's motives and determinative process, while at the same time ensuring that the board is afforded sufficient latitude and deference to remain "the defender of the metaphorical medieval corporate bastion and the protector of the corporation's shareholders."[115] In striking this delicate balance, *Unocal* and its progeny have been simultaneously subjected to "unrelenting" academic criticism[116] and hailed as "the most innovative and promising case in [Delaware's] recent corporation law."[117]

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

113. Andrew G.T. Moore II, *The Birth of Unocal—A Brief History*, 31 DEL. J. CORP. L. 865, 883 (2006) (characterizing *Unocal* as an "intermediate standard of review between the traditional business judgment rule and the fairness test").

114. *Unitrin*, 651 A.2d at 1377 n.18; *see* Stephen M. Bainbridge, *Unocal at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769 (2006). According to Bainbridge:

> [T]he *Unocal* test is more properly seen as a conditional version of the business judgment rule, rather than an intermediate standard of review lying between the duties of care and of loyalty. The *Unocal* standard solved the problem of outcome determination not so much by creating a different standard of review, but rather by creating a mechanism for determining on an individual basis which of the traditional doctrinal standards was appropriate for the particular case at bar.

Id. at 800 (citations omitted). The threshold determination of the appropriate level of review may be the "whole ball game." *Id.*; *see also* William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 26 DEL. J. CORP. L. 859, 884 (2001) (arguing that "once the target company board's defensive actions are found to satisfy or fail the *Unocal* test, any further judicial review of those actions under the business judgment or entire fairness standards is analytically and functionally unnecessary").

115. *Unitrin*, 651 A.2d at 1388; *see also* Moore, *supra* note 113, at 881.

116. *See* Bainbridge, *supra* note 114, at 770-72 (suggesting that *Unocal* is "almost universally condemned in the academic corporate law literature") (citing Ronald J. Gilson, *Unocal Fifteen Years Later (and What We Can Do About It)*, 26 DEL. J. CORP. L. 491, 512 (2001) (characterizing *Unocal* as "a failure")); *see also* Jennifer J. Johnson & Mary Siegel, *Corporate Mergers: Redefining the Role of Target Directors*, 136 U. PA. L. REV. 315, 330-31 (1987) (characterizing *Unocal* as a "toothless standard"); Mark J.

As refined and clarified by the Delaware Supreme Court in *Unitrin v. Am. Gen. Corp.*,[118] the *Unocal* standard relies upon two analytical prongs. The first prong focuses upon the board's deliberative process and the legitimacy of the threat encountered. To satisfy this aspect of the test, the board must establish that it had "reasonable grounds for believing that a danger to corporate policy and effectiveness existed," a burden that can be satisfied by showing good faith and reasonable investigation.[119] Threats that have been deemed legitimate for this purpose, and thus sufficient to justify the implementation of defensive measures, include potential injury or harm to the corporation or its assets, the derailing or diminution of a long term corporate strategy,[120] the loss of the opportunity to formulate and present a potentially superior alternative,[121] the sheer inadequacy (not to say formal "unfairness") of the consideration offered to the stockholders, or, under certain circumstances, the risk of stockholder confusion or coercion.[122] The

Loewenstein, *Unocal Revisited: No Tiger in the Tank*, 27 J. CORP. L. 1, 3 (2001) (characterizing *Unocal* as a "toothless tiger"). Other commentators contend that the evolving *Unocal* standard functions as little more than a "dressed-up business judgment rule." *See* Bradley R. Aronstam, *The Interplay of Blasius and Unocal—A Compelling Problem Justifying the Call for Substantial Change*, 81 OR. L. REV. 429, 430 (2002); *see also* Paul L. Regan, *What's Left of Unocal?*, 26 DEL. J. CORP. L. 947, 950 (2001) (suggesting that the practical effect of *Unocal* scrutiny is "modestly limited to ensuring that the shareholders are not mathematically eliminated from winning a contested election to replace the board").

117. City Capital Assocs. Ltd. P'ship v. Interco Inc., 551 A.2d 787, 796 (Del. Ch. 1998); *see also* Gregory W. Werkheiser, *Defending the Corporate Bastion: Proportionality and the Treatment of Draconian Defenses from Unocal to Unitrin*, 21 DEL. J. CORP. L. 103, 103 (1996) (recounting that the *Unocal* standard "revolutionized Delaware takeover law" and stating that its "significance . . . cannot be overstated").

118. *Unitrin*, 651 A.2d at 1361.

119. Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946, 955 (Del. 1985); *see also* Chesapeake Corp. v. Shore, 771 A.2d 293, 330 (Del. Ch. 2000) (quoting *Unitrin*, 651 A.2d at 1375). Even before *Unocal*, Delaware jurisprudence placed the burden on directors to demonstrate "good faith and reasonable investigation" when evaluating defensive conduct. *See* Cheff v. Mathes, 199 A.2d 548, 555 (Del. 1964).

120. Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1154 (Del. 1989) ("Directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy."). In evaluating defensive measures, the Delaware Supreme Court has given weight to directors' concerns that institutional investors are more likely to forego superior future returns for an immediate, present premium. *Id*. at 1148. Conversely, stockholder confusion is less likely to be deemed a legitimate threat where institutional investors are heavily involved. *Chesapeake*, 771 A.2d at 326-27.

121. Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 107-08 (Del. Ch. 2011) (quoting Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 278, 289 (Del. Ch. 1989)).

122. The concept of substantive coercion "posits that a tender offer can pose a threat to stockholders simply because the stockholders may mistakenly reject the board's view that the offer is not adequate." Leo E. Strine, Jr., *The Professorial Bear Hug: The ESB Proposal as a Conscious Effort to Make the Delaware Courts Confront the Basic "Just Say No" Question*, 55 STAN. L. REV. 863, 875 (2002) (citing Ronald J. Gilson & Reinier

latter two threats are "inextricably related" through the concept of substantive coercion, defined as "the risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representations of intrinsic value."[123] This has been explicitly recognized as a legally cognizable threat under *Unocal*.[124]

Embedded within *Unocal*'s first prong is the requisite element of good faith with respect to the directors' decision. This element necessitates that directors act faithfully in response to a legitimately perceived threat and not in furtherance of personal or other ulterior motives such as entrenchment.[125] The presence of a majority of outside independent directors without more will serve as a *prima facie* showing of good faith and reasonable investigation for purposes of this aspect of the *Unocal* analysis.[126] Nonetheless, while it has been said that good faith is a critical cornerstone of the judicial review of defensive measures, the board's ability to establish the good faith of its decisions is not alone sufficient to ensure judicial validation of those decisions. Indeed, the Delaware Supreme Court invoked the *Unocal* analysis to invalidate a lockup arrangement in a negotiated acquisition,[127] notwithstanding the target board's independence, apparent good faith, and reasonable investigation.[128]

Even when a reasonably perceived threat is deemed legitimate, the board's resulting defensive action will nonetheless be judicially scrutinized to ensure that it satisfies the second prong of the *Unocal* test.[129] To do so, the board must establish that the defensive measures

Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 248 (1989)).

123. *Airgas*, 16 A.3d at 96, 108 (citing *Paramount Commc'ns*, 571 A.2d at 1153).

124. *Id.* at 99, 124 (citing *Paramount Commc'ns*, 571 A.2d at 1153).

125. *Unocal*, 493 A.2d at 954-55.

126. Selectica, Inc. v. Versata Enters., Inc., No. 4241-VCN, 2010 WL 703062, at *12 (Del. Ch. Feb. 26, 2010); *see also Chesapeake* Corp. v. Shore, 771 A.2d 293, 330 (quoting *Unitrin*, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1375 (Del. 1995)). Note in addition that Delaware law does not require that a board consult outside advisors in the course of its reasonable investigation so long as the board can otherwise demonstrate that it has adequate information with which to make an informed judgment. *Chesapeake*, 771 A.2d at 331.

127. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 934 (Del. 2003).

128. *Id*. at 946 (Steele, J., dissenting).

129. Yucaipa Am. Alliance Fund II, L.P. v. Riggio, 1 A.3d 310, 337 (Del. Ch. 2010) ("*Unitrin* left room for a determination that a non-preclusive, non-coercive defensive measure was nonetheless unreasonable in light of the threat faced by the corporation."); *see also* Mentor Graphics Corp. v. Quickturn Design Sys., Inc., 728 A.2d 25, 50-51 (Del. Ch. 1998) (holding a poison pill to be neither coercive nor preclusive, but enjoining it for falling outside the range of reasonableness), *aff'd sub nom.* Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281 (Del. 1998); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 112-15 (Del. Ch. 1986) (enjoining target corporation's purchase of its own stock and resale of stock to a newly formed employee stock option plan as unreasonable

adopted reflect a response that is proportionate to the perceived threat, and thus that they are not draconian but instead within the range of reasonableness.[130] Defensive measures that are intrinsically preclusive or coercive are "included within the common-law definition of draconian" and are therefore deemed unreasonable *per se*.[131]

Although *Unocal* review is applicable to all defensive measures, including those that are designed to defend against challenges to corporate control, the judicial assessment of whether a defensive measure or response is preclusive most often focuses on its anticipated impact upon stockholder voting. This is because the most important and respected instrumentality by which stockholders may exercise their right to effect a change in corporate policy is the ballot box, and the question whether under the *Unocal* analysis the challenged defensive action is preclusive often turns on the extent to which it does or does not restrict the continued availability of the stockholders' unfettered opportunity to vote.[132] The abiding right of stockholders, undiminished notwithstanding the board's adoption of defensive measures, to replace the board and thus put an end to its ability to oppose unsolicited advances, often results in a finding that such measures are not preclusive and thus will instead be judicially assessed to determine whether they otherwise fall within the range of reasonableness.[133] On the other hand, a finding that the actions are draconian by reason of preclusion is far more likely when defensive actions by the board directly or coincidentally operate to constrain the ability of stockholders to cast their vote.[134] In the context of a lock-up or deal protection device, this inquiry will center upon whether, notwithstanding such device, a rival prospective bidder has an

defensive measures in relation to the threat posed, despite holding that such measures served a valid corporate purpose in response to a legitimate threat).

130. *Unitrin*, 651 A.2d at 1387-88.

131. *Id*. at 1387. For additional commentary regarding the evaluation of draconian measures, see generally Werkheiser, *supra* note 117.

132. *See, e.g.*, *Yucaipa*, 1 A.3d at 336 ("'*Unitrin* recognized the importance of examining whether the company's defensive arsenal as a whole, including the pill, was preclusive in the precise sense of making it unrealistic for an insurgent to win a proxy contest.'") (citing *Unitrin*, 651 A.2d at 1387).

133. *See, e.g.*, *Yucaipa*, 1 A.3d at 336; *Unitrin*, 651 A.2d at 1387; c*f.* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 122 n.480 (Del. Ch. 2011).

134. Indeed, because of the profound importance of the stockholders' right to vote to the corporate governance regime as a whole, an extremely rigorous judicial standard applies to any board action undertaken "for the sole or primary purpose of thwarting a shareholder vote." In such circumstances, the board must overcome "the heavy burden of demonstrating a compelling justification for such action." Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 661-62 (Del. Ch. 1988).

opportunity to make a topping bid.[135] In the context of fending off an unwanted suitor, Delaware courts recognize that a would-be acquiror has at its disposal the "viable alternative" of a proxy contest.[136] In this context, Delaware courts focus upon whether a defensive measure is preclusive "in the precise sense of making it unrealistic for an insurgent to win a proxy contest."[137] To establish that a challenged defensive measure is not preclusive, directors therefore must show that it is "realistic" for an insurgent to prevail in a proxy contest.[138] The Delaware courts have provided some conflicting guidance regarding the degree of likelihood required, however, having on occasion suggested that a defensive measure is preclusive when an insurgent confronts a "mathematical impossibility" or "near impossibility" for a successful proxy contest,[139] while in other cases focusing instead upon whether an insurgent has a "fair chance for victory."[140] Although the precise parameters of preclusion are murky, it is clear that the concept entails more than merely making it "more difficult" for a would-be acquiror to obtain board control.[141]

A defensive measure will be deemed "coercive" where it has the effect of causing stockholders to act for some reason other than the merits of the transaction.[142] Put differently, a defensive measure is coercive when it necessarily constrains or dictates the way that a "rational profit-maximizing shareholder" can reasonably be expected to respond.[143] A common example is a defensive action that essentially constitutes a "cram-down" proposal by the target board: one that gives stockholders no legitimate choice but to approve the board's alternative and/or to forego the unsolicited opportunity. In *AC Acquisitions Corp. v.*

135. *See, e.g.*, *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 615 (Del. Ch. 2010) ("Certainly, I cannot call the deal protections preclusive, in that they left any serious bidder with the chance to buy the company. . . .").

136. *Unitrin*, 651 A.2d at 1389 n.39.

137. *Yucaipa*, 1 A.3d at 336 (citation omitted). *Cf. Airgas*, 16 A.3d at 122 n.480 (noting that, through *Unocal*'s evolution, Delaware courts effectively have "allowed a board acting in good faith (and with a reasonable basis for believing that a tender offer is inadequate) to remit the bidder to the election process as its only recourse").

138. *Unitrin*, 651 A.2d at 1389.

139. *See* Selectica, Inc. v. Versata Enters., Inc., No. 4241-VCN, 2010 WL 703062, at *22 (Del. Ch. Feb. 26, 2010), *aff'd*, 5 A.3d 586 (Del. 2010).

140. *Yucaipa*, 1 A.3d at 337 n.182 ("[T]he mere fact that the insurgent might have some slight possibility of victory does not render the measure immune from judicial proscription as preclusive.").

141. *Versata*, 5 A.3d 586, 604 (Del. 2010) (citing *In re* Gaylord Container Corp. S'holders Litig., 753 A.2d 462, 482 (Del. Ch. 2000)).

142. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 935 (Del. 2003) (citing Williams v. Geier, 671 A.2d 1368 (Del. 1996)).

143. AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 113 (Del. Ch. 1986).

Anderson, Clayton & Co.,[144] for example, the Delaware Court of Chancery deemed the self-tender at issue to constitute a reasonable response to a legitimately perceived threat, but nonetheless found that it was coercive because "no rational shareholder could afford not to tender into the Company's self-tender offer" because doing so was the only way to avoid an immediate financial loss.[145] Accordingly, the defensive measure was invalidated as coercive under *Unocal's* second prong.[146]

When a target adopts multiple defensive measures, Delaware courts will assess their collective effect and reasonableness as a defensive package for purposes of the *Unocal* test. In examining the validity of multiple defensive measures aggregated together, Delaware courts must "make a judicial determination as to whether each provision, on its own and in combination with all others . . . [is] reasonable and do[es] not preclude a higher bid from being successful."[147]

B. Customary Deal Protection Devices

Delaware courts view reasonable negotiated deal protection terms as important "bargained-for rights" that "need to be protected."[148] A target board, however, may not undertake or agree to include provisions that employ protective terms in order to lock-up or unreasonably protect a favored transaction at the expense of a reasonably unfettered opportunity for stockholders to exercise their statutory franchise to approve or disapprove of the proposed transaction or to erect unwarranted impediments to rival topping bids. Deal protection terms that are self-evidently designed to deter or dissuade alternative transactions are considered defensive in nature and reviewed under the *Unocal* standard.[149]

144. *Id.* at 103.
145. *Id*. at 113.
146. *Id*. at 112-14.
147. *In re* Cogent, Inc. S'holder Litig., 7 A.3d 487, 497 (Del. Ch. 2010) (citing Revlon, Inc. v. MacAndrews & Forbes Holding, Inc., 506 A.2d at 182, 184 n.16 (Del. 1986)); *see also* La. Mun. Police Emps.' Ret. Sys. v. Crawford, 918 A.2d 1172, 1181 n.10 (Del. Ch. 2007) (noting the need for courts to consider "the preclusive or coercive power of *all* deal protections included in a transaction, taken as a whole") (emphasis in original).
148. NACCO Indus., Inc. v. Applica Inc., 997 A.2d 1, 19 (Del. Ch. 2009) ("It is critical to our law that those bargained-for rights be enforced, both through equitable remedies such as injunctive relief and specific performance, and, in the appropriate case, through monetary remedies including awards of damages, [as failure to do so] would have serious and adverse ramifications for merger and acquisitions practice and for our capital markets.").
149. Omnicare, Inc. v. NCS Healthcare, Inc., 818 A.2d 914, 931-33 (Del. 2003) (noting that "[a] board's decision to protect its decision to enter a merger agreement with defensive devices against uninvited competing transactions that may emerge is analogous

In addition to termination fees and no-shop or no-talk provisions, discussed immediately below, merging parties have available to them myriad contractual protective devices to lock-up, insulate, or advance a favored transaction. By way of example, merger agreements often include provisions requiring the target board to undertake certain actions in the event a potentially superior offer emerges, such as notifying the initial counterparty or permitting such counterparty a specified time period in which to match the topping offer (in common parlance, "matching rights"). Delaware courts have recognized that matching rights may entice initial bidders, and that it may be "reasonable for a seller to provide a buyer some level of assurance that he will be given adequate opportunity to buy the seller, even if a higher bid later emerges."[150]

Counterparties also frequently agree to a contractual requirement that the target company submit the original proposed transaction to a stockholder vote even when a competing bid has emerged and has resulted in a change in the target board's recommendation. Such "force-the-vote" provisions have gained popularity since Delaware provided express statutory clarification that mergers (or any other matter) may be submitted for a stockholder vote without a favorable board recommendation.[151] Further, parties to a transaction frequently enter into support or voting agreements with sizeable stockholders to bolster the likelihood of the transaction garnering stockholder approval. But such provisions, particularly when employed in tandem, are by no means invulnerable to stockholder attack or judicial invalidation where their effect can be shown to be inherently coercive, preclusive, or unreasonable and disproportionate under the specific circumstances at hand.[152]

to a board's decision to protect against dangers to corporate policy and effectiveness when it adopts defensive measures in a hostile takeover contest"); *see also* McMillan v. Intercargo Corp., 768 A.2d 492, 506 n.62 (Del. Ch. 2000) (noting that deal protection devices "primarily 'protect' the deal and the parties thereto from the possibility that a rival transaction will displace the deal" and that "[s]uch deal protection provisions accomplish this purpose by making it more difficult and more expensive to consummate a competing transaction and by providing compensation to the odd company out if such an alternative deal nonetheless occurs"); Gregory V. Varallo & Srinivas M. Raju, *A Fresh Look At Deal Protection Devices: Out From the Shadow of the Omnipresent Specter*, 26 DEL. J. CORP. L. 975, 979 (2001) (discussing the limits and parameters of the *Unocal* standard's application to deal protection devices).

150. *In re Cogent*, 7 A.3d at 500 (Del. Ch. 2010) (denying motion for preliminary injunction).

151. *See* DEL. CODE ANN. tit. 8, § 146 (West 2003).

152. A merger cannot be fully "locked up" through such support agreements so as to preclude stockholders from accepting a better deal and render the contemplated transaction a *fait accompli* irrespective of topping bids. *Omnicare*, 818 A.2d at 936.

A target board may also protect a deal by granting certain rights to the initial counterparty in the event the transaction does not close. While termination fees are the most straightforward example of such rights, the initial counterparty is sometimes contractually guaranteed to receive an option to purchase a percentage of the target's stock or an option to buy a desirable part of the target (a "crown jewel option")[153] under certain pre-defined circumstances. The question often presented in such circumstances is whether the fee or the option, typically justified as necessary to entice the buyer to commit contractually at a higher price, is so large or so valuable as to render the company materially less attractive or valuable to potential competing bidders.

Deal protection measures may be particularly problematic if they contractually "limit" or "circumscribe" the directors' ability to comply with their fiduciary obligations.[154] Because a target board has a statutory responsibility to continue to make recommendations on a merger transaction to stockholders right up until the time of its presentation to stockholders for approval, and a concomitant fiduciary obligation to inform itself as to the propriety of its recommendation throughout that period, it is typically expected that the target board will contract for an effective "fiduciary out" provision to ensure that it remains free to exercise its continuing fiduciary responsibilities to its stockholders during the period following the execution of the merger agreement and prior to the presentation of the transaction for stockholder approval.[155]

1. "No-Shop" and "No-Talk" Provisions

Merger agreements and other negotiated instruments often contain covenants or provisions that prohibit the target company from affirmatively soliciting rival offers or otherwise shopping itself ("no-shop" provisions), or from entering into negotiations or otherwise providing information to other potential acquirors ("no-talk" provisions), once the merger agreement has been signed. No-shop and no-talk provisions are relatively commonplace and are generally regarded as customary deal provisions.[156] A properly crafted no-shop provision does not foreclose superior offers, but it does afford protection to prevent disruption to the contemplated transaction from third parties whose

153. *See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986) (affirming injunction of a crown jewel option in favor of a white knight as a breach of fiduciary duty).

154. *Omnicare*, 818 A.2d at 938.

155. *Id*. at 939.

156. *See* ACE Ltd. v. Capital Re Corp., 747 A.2d 95, 106 (Del. Ch. 1999) (suggesting that no-shop provisions are "perfectly understandable, if not necessary, if good faith transactions are to be encouraged").

proposals are neither bona fide nor reasonably likely to result in a superior transaction.[157] Accordingly, the presence of a no-shop or no-talk provision is "hardly indicative" of a *Unocal* breach,[158] particularly where such provisions include a typical "fiduciary out" authorizing the target board to engage in the proscribed conduct should it determine that the failure to do so would constitute a breach of its fiduciary duties.

Delaware courts have routinely held that no-shop or no-talk provisions, coupled with matching rights, are neither unreasonable nor preclusive under *Unocal*.[159] On the other hand, a flat no-talk or no-shop provision that contains no room for discretion in accordance with the board's fiduciary obligations has been held to constitute an unreasonable, disproportionate, and draconian defensive obstacle under the *Unocal* standard.[160]

2. Termination Fees

A party to a merger agreement may seek recompense by way of an agreed-upon fee payable in the event the agreement is terminated under certain circumstances, most frequently in the event of the emergence and acceptance of a superior bid or the target's failure to secure stockholder approval. It is well settled that such termination or break-up fees are permissible under Delaware law.[161] The question typically presented is whether such a fee is reasonable and proportionate under the circumstances and, in particular, whether it is so large as to deter the

157. *See, e.g.*, Matador Capital Mgmt. Corp. v. BRC Holdings, Inc., 729 A.2d 280, 291 (Del. Ch. 1998) (recognizing that no-shop measures "do not foreclose other offers, but operate merely to afford some protection to prevent disruption of [an] [a]greement by proposals from third parties that are neither bona fide nor likely to result in a higher transaction").

158. McMillan v. Intercargo Corp., 768 A.2d 492, 506 (Del. Ch. 2000).

159. *See, e.g.*, *In re* Atheros Commc'ns, Inc., No. 6124–VCN, 2011 WL 864928, at *7 n.61 (Del. Ch. Mar. 4, 2011) (denying preliminary injunction for no-shop and matching rights provision); *In re* Cogent, Inc. S'holder Litig., 7 A.3d 487, 502 (Del. Ch. 2010) (same); *In re* Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1001 (Del. Ch. 2005) (same).

160. *See ACE*, 747 A.2d at 107; *see also* Phelps Dodge Corp. v. Cyprus Amax Metals Co., Nos. 17398, 17383, 17427, 1999 WL 1054255, at *2 (Del. Ch. Sept. 27, 1999) (suggesting that a flat no-talk provision without a fiduciary out is "the legal equivalent of willful blindness").

161. *In re* IXC Commc'ns, Inc. v. Cincinnati Bell, Inc., No. 17324, 1999 WL 1009174, at *10 (Del. Ch. Oct. 27, 1999) (citing QVC Network, Inc. v. Paramount Commc'ns, 635 A.2d 1245 (Del. Ch. 1993), *aff'd sub nom.* Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34 (Del. 1994)); *see also In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 613-14 (Del. Ch. 2010) (approving a 3.9% fee and noting that "[t]he preclusive aspect of any termination fee is properly measured by the effect it would have on the desire of any potential bidder to make a topping bid."); *In re Toys "R" Us,* 877 A.2d at 1015-21 (approving a 3.75% of equity value termination fee); *McMillan*, 768 A.2d at 505-06 (approving a 3.5% fee).

emergence of bidders who would be inclined to come forward with a superior offer but for the existence of the fee obligation.

No "blanket rule" or bright-line standard prescribes whether or not a termination fee is reasonable.[162] While the judicial inquiry necessarily will be affected by the specific circumstances presented, such as the extent to which the company was shopped prior to the signing of the merger agreement, the overall likelihood that other bidders may be interested in entering into a merger transaction on superior terms, or the proportionality of the fee in relation to the value and financial circumstances of the company in question, it can be said that Delaware courts have generally held termination fees to be reasonable when such fees reflect less than three-percent of the equity deal value.[163] Under certain specific circumstances, Delaware courts have even sanctioned fees as high as five percent of the equity deal value.[164] Where a termination fee is implemented in tandem with other deal protection devices, Delaware courts will consider the reasonableness, coerciveness, and preclusive nature of such devices on a cumulative basis.[165] Notwithstanding the directors' burden under *Unocal*, a stockholder challenging customary or commonplace deal protection devices may face an uphill battle.[166]

C. Protections against Hostile Takeovers

Delaware law affords directors considerable "latitude in discharging [their] fiduciary duties to the corporation and its shareholders when defending against perceived threats"[167] in recognition of the fact that reasonable and proportionate defensive tactics may be appropriate or

162. La. Mun. Police Emps.' Ret. Sys. v. Crawford, 918 A.2d 1172, 1181 n.10 (Del. Ch. 2007).

163. *See generally In re Cogent*, 7 A.3d at 503 ("A termination fee of 3 percent is generally reasonable.") (citation omitted).

164. *See* Matador Capital Mgmt. Corp. v. BRC Holdings, Inc., 729 A.2d 280, 291 n.15 (Del. Ch. 1998) (noting that termination fees are "commonplace" and that termination fees "in the range of 1 percent to 5 percent of the proposed acquisition price are reasonable") (citation omitted).

165. *In re* Answers Corp. S'holders Litig., No. 6170-VCN, 2011 WL 1366780, at *4 n.47 (Del. Ch. Apr. 11, 2011) (denying motion for preliminary injunction with relation to deal protections including "a termination fee plus expense reimbursement of 4.4% . . . a no solicitation clause, a 'no-talk' provision . . . a matching rights provision, and a force-the-vote requirement").

166. *In re* Ness Techs., Inc. S'holders Litig., No. 6569-VCN, 2011 WL 3444573, at *2 (Del. Ch. Aug. 3, 2011) (holding that deal protections, including a no-shop provision and "termination fee amounting to 2.72% of the sale price," were insufficient to raise a colorable claim, and emphasizing that the plaintiffs "offer[ed] no explanation as to how these relatively mundane deal protections would prevent a serious bidder from making a superior offer").

167. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1388 (Del. 1995).

necessary to protect stockholders and the corporate enterprise. Directors have the power and responsibility to adopt appropriate defensive measures, as well as the corresponding power and responsibility to maintain or dismantle such measures at an appropriate time.

In delineating the boundaries within which the board may act to thwart hostile takeover attempts, *Unocal* and its progeny focus upon the need for active, empowered directors. According to former-Justice Andrew G.T. Moore II, author of the Delaware Supreme Court's *Unocal* opinion:

> [The Delaware courts] could not accept the . . . notion of passivity by a board in a takeover context. Such a position only expose[s] a company and its stockholders to raiders who [use] coercive tactics to acquire control with cheap, undervalued bids. In the jargon of the financial community, that [leaves] companies and their stockholders naked in the street ready to be flattened by a steamroller.[168]

The defensive measures available to directors seeking to thwart a hostile bidder, and thereby to avoid the proverbial "steamroller," are "as numerous as the creative board can imagine."[169]

The defensive measures most commonly implemented by a target board in response to a reasonably perceived threat, whether alone or in combination, include classified boards, advance notice by-laws, supermajority voting provisions, and stockholder rights-plans.[170] In lieu of or in addition to such measures, targets of unsolicited acquisition bids frequently seek the intervention and assistance of a "white knight"[171] or "white squire."[172] Alternatively, through the so-called "Pac-Man" defense, a target company can counter a hostile tender offer by making its own tender offer for the stock of the would-be acquiror, thereby consuming its rival.[173] A target could also respond to a hostile takeover attempt by recapitalizing or otherwise financially restructuring. For

168. Moore, *supra* note 113, at 881.

169. Aronstam, *supra* note 116, at 435.

170. *Unitrin*, 651 A.2d at 1388 n.38 ("[I]f a board reasonably perceives that a threat is on the horizon, it has broad authority to respond with a panoply of individual or combined defensive precautions, e.g., staffing the barbican, raising the drawbridge, and lowering the portcullis.").

171. In corporate parlance, a "white knight" is a friendly alternative partner who rescues the target company from the clutches of a hostile bidder. *See* Gilbert v. El Paso Co., 575 A.2d 1131, 1136 n.12 (Del. 1990).

172. A "white squire" is a friendly third party opposed to the hostile acquiror to whom the target provides equity or debt securities, thereby securing a significant block of aligned voting power. *See* Nomad Acquisition Corp. v. Damon Corp., Nos. 10173, 10189, 1988 WL 96192, at *3 (Del. Ch. Sept. 16, 1988).

173. Moran v. Household Int'l, Inc., 500 A.2d 1346, 1350 n.6 (Del. 1985) (citation omitted).

example, a target board's strategic adoption of an employee stock ownership plan may constitute a defensive measure that implicates *Unocal* review, particularly when the shares implicated in the plan are of a critical size and are voted by incumbent management.[174]

As discussed above, a target board's response to a hostile takeover implicates the "omnipresent specter" that even an otherwise entirely independent board may be acting to advance its own interests in remaining in office at the expense of the corporation and its stockholders.[175] Enhanced scrutiny under *Unocal* mitigates this inherent conflict by more critically assessing the target board's decision to adopt, use, or dismantle a defensive measure. Delaware law does not require a board to wait until the "eve of battle" to decide whether to adopt sound defensive barriers, as such a requirement "would encourage haste rather than due care."[176] Delaware courts instead recognize that "pre-planning for the contingency of a hostile takeover" (as opposed to adopting defensive measures in the face of a specific threat) is a prudent approach to minimizing risk, and that the deferential presumptions of the business judgment rule may be "even more appropriate" for such pre-planned defensive mechanisms.[177] Judicial approval of the adoption of a defensive measure on a "clear day" does not diminish or abrogate the board's burden to justify its use of those defenses in the "heat of battle" under the *Unocal* standard.[178]

Two varieties of defensive measures warrant particular focus: so-called "shark repellents" and the poison pill.

1. Classified Boards and Other Shark Repellents

"Shark repellents" are provisions in a company's bylaws or articles of incorporation that have the effect of deterring a prospective bidder's interest in the company as a takeover target,[179] thereby giving the target board additional leverage in negotiating or rebuffing takeover terms. Such "shark repellant" provisions include the following: (i) staggered terms for directors, (ii) super-majority voting requirements that necessarily protect the status quo, (iii) "fair price" guarantees that provide for consent rights or super-majority voting unless the price or premium in a prospective transaction meets a specified threshold,

174. *See* Eric Grannis, *A Problem of Mixed Motives: Applying Unocal to Defensive ESOPs*, 92 COLUM. L. REV. 851 (1992).
175. Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946, 954 (Del. 1985).
176. *In re* Gaylord Container Corp. S'holders Litig., 753 A.2d 462, 478 (Del. Ch. 2000) (citations omitted).
177. *Moran*, 500 A.2d at 1350.
178. Hills Stores Co. v. Bozic, 769 A.2d 88, 106-07 (Del. Ch. 2000).
179. *See* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1377 n.19 (Del. 1995).

(iv) restrictions on the ability of stockholders to call a special meeting[180] or act by written consent,[181] and (v) a host of alternative impediments to sudden changes in corporate control.

Under Delaware law, classified or staggered boards are authorized by statute. The charter or a stockholder-approved bylaw of a Delaware corporation may provide for classification into as many as three classes of directors;[182] such provisions are often regarded as constituting an obstacle to a hostile suitor. Where a board is split into three classes, approximately one-third of the board is up for election at any annual or special meeting, thereby preventing an insurgent from placing a majority of its nominees on the board in a single election.[183] A classified board therefore serves to "delay—but not prevent—a hostile acquiror from obtaining control of the board."[184]

Although classified boards are statutorily authorized, board action relating thereto nonetheless may implicate *Unocal*. In Chesapeake Corp. v. Shore,[185] for example, then-Vice Chancellor Strine struck down an amendment to the target corporation's bylaws, adopted without stockholder approval, that would have required a two-thirds stockholder vote to alter the bylaws and declassify the board.[186] In so ruling, Vice Chancellor Strine held that the threat was relatively modest and that the bylaw amendment was an unreasonable and disproportionate response thereto, particularly since a poison pill had also been implemented.[187]

180. *See In re Gaylord*, 753 A.2d at 482.

181. Delaware law provides that any action required to be taken at an annual or special meeting may be taken by written consent "[u]nless otherwise provided in the certificate of incorporation." DEL. CODE ANN. tit. 8, § 228(a) (West 2009).

182. *Id.* § 141(d) (limiting the maximum term of any director on such a board to three years). Unless the charter provides otherwise, directors of a company with a classified board can only be removed for cause. *Id.* § 141(k)(1).

183. MM Cos., Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1122 (Del. 2003) (citing Lucian Ayre Bebchuk, John C. Coates, IV & Guhan Subramanian, *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887 (2002)).

184. Versata Enters., Inc. v. Selectica, Inc., 5 A.3d 586, 604 (Del. 2010) (quoting Carmody v. Toll Bros., Inc., 723 A.2d 1180, 1186 n.17 (Del. Ch. 1998)). For further commentary on the utility and costs of classified boards, see Lucian A. Bebchuk & Alma Cohen, *The Costs of Entrenched Boards*, 78 J. FIN. ECON. 409 (2005).

185. Chesapeake Corp. v. Shore, 771 A.2d 293 (Del. Ch. 2000).

186. *Id*. at 297-304.

187. *Id*. To the extent they implicate or threaten the stockholder franchise, shark repellent measures may also be subject to heightened scrutiny under *Blasius* and its progeny, thus requiring the board to demonstrate a "compelling justification" in order to justify the constraining effect on the exercise of the stockholder franchise. *See, e.g.*, *MM Cos.*, 813 A.2d at 1118 (applying *Blasius* and striking down an increase in board size in response to a proxy contest).

2. Poison Pills

Stockholder rights-plans, commonly referred to as "poison pills," represent one of the most potent defensive measures used by target boards to defend against unsolicited takeover attempts.[188] Although poison pills can take various forms,[189] they share a typical structure: a triggering event—such as an unauthorized or unfriendly acquiror's acquisition of some threshold percentage of the target's outstanding stock—is deemed to cause certain "rights" to become operational for all target stockholders except the hostile acquiror. In a common formula, such rights will permit the stockholder to purchase stock of the target (or acquiror) at a significantly discounted price. The poison pill thus renders the contemplated acquisition so prohibitively and undesirably expensive that the would-be acquiror is forced to negotiate with the existing board or to launch a proxy contest with the hope of replacing the board and thereafter redeeming the rights-plan. Rights-plans thus serve as a tool that "gives the target board leverage to negotiate with a would-be acquiror so as to improve the offer as well as the breathing room to explore alternatives to and examine the merits of an unsolicited bid."[190] A properly implemented poison pill "provides the directors with a shield to fend off coercive offers and with a gavel to run an auction."[191]

It is well settled that a Delaware corporation may adopt a poison pill. In *Moran v. Household Int'l, Inc.*,[192] the Delaware Supreme Court

188. Although typically considered an anti-takeover device, a poison pill can also serve to protect specific corporate assets against an outside threat. Selectica, Inc. v. Versata Enters., Inc., No. 4241-VCN, 2010 WL 703062, at *15 (Del. Ch. Feb. 26, 2010), *aff'd*, 5 A.3d 586 (Del. 2010).

189. Mentor Graphics Corp. v. Quickturn Design Sys., Inc., 728 A.2d 25, 27 (Del. Ch. 1998) (noting that the poison pill's evolution has been a "work-in-progress, with each variation and innovation generating new litigation and occasions for judicial opinion writing"), *aff'd sub nom.* Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281 (Del. 1998).

190. *In re* Gaylord Container Corp. S'holders Litig., 753 A.2d 462, 481 (Del. Ch. 2000); *see also* Yucaipa Am. Alliance Fund II, L.P. v. Riggio, 1 A.3d 310, 351 (Del. Ch. 2010) (upholding the validity of a board's interest in driving a potential acquiror to the board for purposes of running a valid sales process, and noting that "the board could reasonably conclude that [the would-be acquiror] should deal with the board in the first instance if it wished to obtain a [control] bloc, and to pay a price to the company's investors that reflected the value of obtaining that power"); Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1088-89 (Del. Ch. 2004) (noting that a properly implanted poison pill "giv[es] the board the breathing room to identify value-maximizing transactions").

191. Facet Enters., Inc. v. Prospect Grp., Inc., 14 Del. J. Corp. L. 310, 320 (Del. Ch. Apr. 15, 1988) (quoting CRTF Corp. v. Federated Dep't Stores, Inc., 683 F. Supp. 422, 439 (S.D.N.Y. 1988)); *see also* Moore, *supra* note 113, at 885 ("With [the Delaware Supreme Court's] approval of the pill . . . hostile takeovers, or the threat of them, were forever changed.").

192. Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985).

first addressed the validity of a poison pill, sanctioning the implementation of a rights-plan containing a "flip-over" provision which was designed to protect the corporation and its stockholders from coercive and inadequate hostile acquisitions.[193] The court held that Section 157 of the General Corporation Law provides broad statutory authority for a board to issue rights containing a "flip-over" feature. The court further concluded that adoption of the rights-plan was a legitimate exercise of business judgment by the defendant directors because the board was fully informed as to the details of the plan, had adopted the plan in the good faith belief that it was necessary to protect the company from coercive acquisition techniques, and had demonstrated that the plan was reasonable in relation to the threat posed.[194] The court noted, however, that a board's refusal to redeem the rights authorized by such a plan in the face of a hostile offer would be tested under the analysis enunciated in *Unocal*.[195] Thus, while such a defensive device is not inherently precluded as long as it does not inhibit the rights of the stockholders, the decision to keep the rights in place will be assessed by the reviewing court to determine the legitimacy of the perceived threat and the proportionality of the response in light of that threat. The Delaware Supreme Court subsequently added texture to this analysis by holding that the combination of a classified board provision and a poison pill is not inherently preclusive, provided that a would-be acquiror has a realistic opportunity to gain control of the target board through a successful proxy contest.[196] Thus, while the opportunity to take majority control of the board cannot be foreclosed, it need not be made immediately available.

The "clear validity" of poison pills as an instrumentality does not relieve directors of their fiduciary duties with respect to the manner in which pills are ultimately used, redeemed, or deployed.[197] The adoption of a rights-plan does not relieve the board of its fiduciary duty to consider in good faith any proposal to acquire the corporation. Directors

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193. *Id.* at 1351-56.

194. *See generally id.* Although the rights-plan considered by the Delaware Supreme Court in *Moran* did not contain a "flip-in" provision or a provision denying certain potential acquirors the benefit of the rights, Delaware courts have frequently upheld the validity of rights-plans containing such features. *See, e.g.*, Versata Enters., Inc. v. Selectica, Inc., 5 A.3d 586, 607-08 (Del. 2010); Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 55 (Del. Ch. 2011); *Yucaipa*, 1 A.3d at 361.

195. *Moran*, 500 A.2d at 1354.

196. *Versata*, 5 A.3d at 604, *accord*, *Airgas*, 16 A.3d at 114.

197. Loventhal Account v. Hilton Hotels Corp., No. 17803, 2000 WL 1528909, at *12 (Del. Ch. Oct. 10, 2000), *aff'd sub nom.* Account v. Hilton Hotels Corp., 780 A.2d 245 (Del. 2001); *see also Moran*, 500 A.2d at 1354-57; Strine, *supra* note 122, at 871 (noting that the downstream or subsequent judicial evaluation of a validly adopted poison pill serves as an implicit "equitable safety device").

are subject to the "same fiduciary standards" under *Unocal* in relation to each board action undertaken with respect to a poison pill,[198] including but not limited to the adoption of such a plan[199] and any subsequent refusal to redeem it.[200] Types of threats that will be deemed sufficient to justify the refusal to redeem rights pursuant to a rights-plan that does not preclude or coerce include the following: threats to established corporate policy or process, threats to the legitimate interests of stockholders by reason of coercion inherent in the structure of the hostile offer, threats of substantive coercion presented by the possibility that stockholders will mistakenly accept an offer with too low a value, or threats premised on the idea that without the "breathing room" that a rights-plan permits, stockholders will be denied the opportunity to assess all available alternatives. It must be noted, however, that this latter justification necessarily limits the duration of the pill's permissible use.[201]

Even though the *Moran* decision was rendered more than a quarter-century ago, the law with respect to the appropriate exercise of the power conferred on a target board has been slow to develop. One Court of Chancery decision rendered only a few years following the *Moran* decision suggested that a board violates *Unocal* if it refuses to redeem a pill in the face of a hostile but necessarily non-coercive, any-or-all cash tender offer.[202] The court reasoned that a *Unocal* violation would occur once the process reached its end stage, it is clear that no better deal is available, and the pill is thus no longer serving any legitimate purpose other than to preclude stockholders from deciding individually whether or not the offer is adequate.[203] This outcome was rejected at the first opportunity by the Delaware Supreme Court, albeit in summary fashion, as a misapplication of Delaware law.[204]

The largely uncertain state of the common law with respect to a board's decision to maintain a pill once negotiations progressed to the end stage persisted until the recent and long-awaited Court of Chancery decision in Air Prods. & Chems., Inc. v. Airgas, Inc.[205] In *Airgas*, the court held that a poison pill could be continuously maintained in the face

198. *Moran*, 500 A.2d at 1354.
199. *See, e.g.*, Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1084-85 (Del. Ch. 2004).
200. *See* City Capital Assocs. Ltd. P'ship v. Interco Inc., 551 A.2d 787, 796 (Del. Ch. 1988).
201. *Hollinger*, 844 A.2d at 1088.
202. *Interco*, 551 A.2d at 798-800.
203. *Id.*
204. Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1153-55 (Del. 1990).
205. Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 100-01 (Del. Ch. 2011). *Cf.* Martin Lipton, *Pills, Polls, and Professors Redux*, 69 U. CHI. L. REV. 1037 (2002) (arguing that directors should be entitled to deploy a pill in order to "just say no" to bids that they deem to be financially inadequate).

of an offer price that an independent board had deemed inadequate.[206] The court so found in the context of a takeover battle that had reached the "end stage," in which no competing bidders had emerged and in which the electorate had been fully educated on the question of valuation by both sides.[207] The court nonetheless concluded that the pill was being maintained for the "principal purpose" of protecting stockholders from accepting an offer that the board believed was inadequate in light of the company's prospects and the synergies that the offeror could be expected to reap upon securing control.[208]

The *Airgas* decision is highly instructive and lends welcome clarity to the parameters within which a board must operate when implementing and maintaining a poison pill; an area of Delaware law that had remained murky in the wake of the 1985 *Moran* decision. The court was asked to determine whether the board of directors of Airgas, Inc. should be required to redeem a rights-plan in the face of a non-coercive, all-cash tender offer from a third party acquiror, Air Products and Chemicals, Inc.[209] Following the submission of Air Products' "best and final offer" of $70 a share, the Airgas board—which had been newly constituted to include three directors nominated by Air Products and elected by Airgas stockholders at Airgas's annual meeting—unanimously rejected Air Products' offer as inadequate.[210]

The court determined that the Airgas board easily satisfied the first prong of *Unocal* by undertaking an investigative process in good faith, as the board was composed of a majority of outside independent directors and relied on the advice of legal counsel, three independent financial advisors, and a detailed and well-developed strategic plan that the Airgas board had carefully reviewed.[211] The court further recognized that under the circumstances presented, a fair value appraisal would be unlikely to properly account for the "enormous value" of near-term, synergistic benefits from Airgas' recent and "substantial" capital investments.[212] This conclusion supported the Airgas board's assessment that the offer, indisputably fair from a financial perspective, was nonetheless inadequate.

The court also explained that although Air Products' offer was not structurally coercive and did not pose a threat of opportunity loss (as there was no alternative bidder), binding Delaware Supreme Court

206. *Airgas*, 16 A.3d at 100-01.
207. *Id.*
208. *Id.*
209. *Id.* at 56.
210. *Id.* at 89.
211. *Id.* at 103.
212. *Id*. at 125-26.

precedent compelled the conclusion that the offer constituted a legally cognizable threat by virtue of offering a price that the Airgas board determined in good faith to be inadequate.[213] The court further held that the Airgas board's defensive measures were proportionate to the perceived threat, and therefore satisfied the second prong of *Unocal*. The court reasoned that Airgas's defensive measures were not preclusive, as Air Products had a realistic opportunity to gain control of the board at Airgas's next annual meeting, approximately eight months away.[214] The defensive measures taken did not "forever" preclude Air Products or any bidder from acquiring Airgas, but merely prevented a change of control from occurring at an inadequate price.[215]

Owing to the existence of certain unusual facts that clearly were important to the court's analysis, a measure of uncertainty continues to surround the issue. Airgas's very promising strategic plan, which pre-existed the receipt of the hostile offer, enjoyed a strong evidentiary basis for its assumptions. Further, the record reflected that the offeror was particularly well-suited to enjoy substantial synergies in the wake of the combination. Additionally, the three nominees to the target board, elected at the behest of the offeror, ultimately concluded upon taking office that the target board's assessment of the offer was correct. These unusual facts lent considerable credibility to the board's determination that the offer, indisputably "fair," was nonetheless inadequate, and quite effectively undermined any suggestion that such a position was motivated not by the valuation merits, but rather by the "omnipresent specter" of entrenchment. Whether the same result can be expected in the absence of such a record cannot be assumed. Moreover, because Air Products withdrew its hostile bid in the wake of the post-trial ruling of the Court of Chancery,[216] the Supreme Court was denied the opportunity to address the issue. Uncertainty necessarily remains.

213. *Id.* at 108 (citing Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1153 (Del. 1990)).
214. *Airgas*, 16 A.3d at 114.
215. *Id.* at 124.
216. Gina Chon, *"Poison Pill" Lives As Airgas Wins Case*, WALL ST. J., Feb. 16, 2011.