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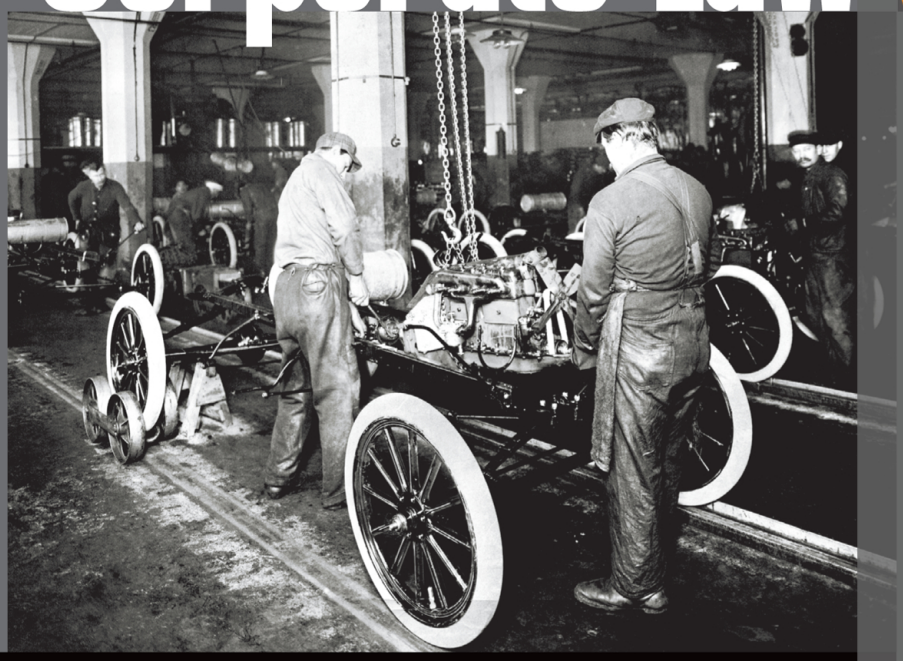
Corporate Law



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CORPORATE LAW STORIES

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The Story of *Blasius Industries v. Atlas Corp.*: Keeping The Electoral Path To Takeovers Clear

I. Introduction

When students take Corporate Law and are instructed in the key takeover decisions of the 1980s and the mid–1990s, the arc of the story often runs from the ''big three'' (*Unocal*,[1] *Moran*[2] and *Revlon*[3]) through *Time–Warner*[4] to *QVC*[5] and *Unitrin*.[6] When M & A is taught more deeply, students are sometimes invited to consider *Van Gorkom*[7] as an M & A case, and to contrast the subtle reasoning of the Chancery decision in the poison pill case of *Interco*[8] with the Supreme Court's dictum in *Time–Warner* criticizing *Interco*.

But, even in more thorough treatments of this critical era in the development of American takeover law, *Blasius Industries, Inc. v. Atlas*

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

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

[3] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1985).

[4] Paramount Communications Inc. v. Time Inc., 1989 WL 79880 (Del. Ch. 1989), *aff'd*, 571 A.2d 1140 (Del. 1989).

[5] QVC Network, Inc. v. Paramount Communications, Inc., 635 A.2d 1245 (Del. Ch. 1993), *aff'd*, 637 A.2d 34 (Del. 1994).

[6] *In re* Unitrin, Inc. Shareholders Litig., 1994 WL 698483 (Del. Ch. 1994), *rev'd and remanded*, 651 A.2d 1361 (Del. 1995).

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

[8] City Capital Associates Ltd. Partnership v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988).

Corp.[9] is often left out of the central chronology of the development of Delaware's jurisprudence regarding a board's discretion to take steps to thwart an unwanted takeover bid. This is not to claim that *Blasius* is not taught; of course, it is. Countless students have read digested versions of *Blasius* as a way of exposing them to the Delaware jurisprudence strictly reviewing director action that monkeys with the electoral process.

What is often slighted, however, is *Blasius*'s role in the central takeover law chronology. In the pages that follow, that is my focus. I place *Blasius* in its original context, a decision issued in the midst of a difficult jurisprudential struggle to define the scope of board authority to address an unprecedented wave of unsolicited takeover bids. In particular, I suggest that certain words that never appear in *Blasius* itself—''poison pill'' and ''just say no''—were very much on the mind of the decision's author, Chancellor William T. Allen.

Having already seen the Delaware Supreme Court hold in *Unocal* and *Moran* that a board's capacious authority to ''manage'' the corporation encompassed actions to defeat a takeover bid,[10] Chancellor Allen knew that it was likely that the Delaware courts would soon face a critical, bottom-line issue. Could a board, having had the chance to find a better deal and to tell its own story, prevent stockholders from accepting a non-coercive tender offer simply because the board believed that the stockholders would be better off by holding their shares and continuing as stockholders under management's pre-existing business plan? If Delaware law trusted stockholders to decide when to buy shares, would it also trust them to decide when to sell their shares? In crude terms, could a board use a poison pill to just say no?

If the answer to that question was essentially yes, the market for corporate control's vitality would turn more and more on the ability of takeover bidders to prevail in a consent solicitation or proxy fight to seat a new board. And if boards were accorded the same latitude to manipulate the electoral process as they were to implement defenses, would the electoral route to a takeover remain viable? And even more fundamentally, if Delaware law permitted directors to impede all paths to a takeover, including that involving the election of a new board, would not it be guilty of the very unprincipled pro-management bias its severest critics accused it of harboring?

In the story that follows, I suggest that precisely these questions were on the mind of Chancellor Allen in deciding *Blasius* and that the central purpose of *Blasius* was to create a firewall, ensuring that no matter how extensive the Delaware Supreme Court found board authori-

[9] 564 A.2d 651, 653 (Del. Ch. 1988).

[10] *See* 8 Del. Gen. Corp. L., § 141(a).

ty to block a tender offer directly to be, bidders would have viable recourse through the election process to effect a change in control. By categorically distinguishing board conduct addressed to the process by which the board itself was elected from ''managerial'' decisions, *Blasius* sought to address the prospect that supposedly heightened *Unocal* review would devolve into a dressed-up version of hands-off business judgment rule review, giving directors enormous leeway to block any bid so long as they harbored a good faith belief that stockholders were better off rejecting it.

When powerful dictum in the *Time–Warner* case savaged his *Interco* decision and implied that a board could just say no to a structurally non-coercive takeover bid, Chancellor Allen's decision in *Blasius* remained, acting as a guarantee that whatever directors might do to impede a tender offer during their term of office, they had no authority to prevent stockholders from seating a new board on the paternalistic grounds that the stockholders did not realize that what was best for them was that the incumbent board remain in power.

II. Chancellor Allen Takes Office as the Delaware Supreme Court Is in the Midst of Deciding **Unocal, Moran,** *and* **Revlon**

William Allen became Chancellor of the Delaware Court of Chancery in June 1985. This was an exciting time to lead the trial court entrusted with handling corporate law disputes in Delaware, home to a majority of the nation's public corporations. Corporate boards were facing an unprecedented wave of unsolicited takeover bids brought by aggressive bidders willing to use litigation to help them land their targets. The moment was particularly right for Allen, who brought to Chancery not only a deep understanding of Delaware's corporate law tradition and culture, but a scholarly bent that inclined him to be receptive to the emerging influence of economics on legal scholarship, and to think that insights from the academy might have utility in helping courts address newly emerging issues.

In fact, the very month the 41-year-old Allen became Chancellor, the Delaware Supreme Court issued its iconic decision in *Unocal Corp. v. Mesa Petroleum Co.*,[11] a decision whose dualistic nature presaged the challenges Allen would face in attempting to forge a coherent body of corporate common law responsive to the takeover boom. In that decision, the Supreme Court gave wide deference to a board of directors that used a coercive, discriminatory self-tender offer to defeat a takeover bid by T. Boone Pickens—who the Supreme Court perceived to be a ''greenmailer'' pushing a bid financed by ''junk bonds''—even though the nature of

[11] 493 A.2d 946 (Del. 1985).

the board's response had many of the same problematic elements as Pickens' own overture.[12]

Critical to that holding was the Supreme Court's interpretation of § 141(a) of the Delaware General Corporation Law (''DGCL''), which stated in relevant part that a corporation was to be ''managed by or under the direction of [the] board of directors.''[13] The Supreme Court held that the term ''management'' encompassed action by the directors to respond to a takeover bid in the form of a tender offer to stockholders, rather than an overture to the corporation itself.[14] That is, the Supreme Court held that it was an act of management for directors to take action that made it more difficult for a tender offeror to consummate an offer he made to the corporation's stockholders, even though the corporation's approval of a tender offer was not required by either federal or state law. Furthermore, having held that it was a proper managerial function for a board to defend against a tender offer, the Court then held that the board could utilize other specific statutory powers—such as the authority of the corporation to deal in its own stock—to fulfill the managerial end of defeating a tender offer that the board opposed.[15]

In brushing aside any argument that the provisions of the DGCL authorizing boards to manage the corporation's ''business and affairs'' and to deal in the company's own stock were not intended to empower boards to make defensively motivated, discriminatory tender offers, the Court stated:

> [O]ur corporate law is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs. Merely because the General Corporation Law is silent as to a specific matter does not mean that it is prohibited.[16]

And, even more generally and without any reference to statutory authority, the Court held that a board's power to take defensive action in response to a takeover bid ''derive[d] from its fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source.''[17] Thus, the Court was ''satisfied that in the broad context of corporate gover-

[12] *Id.* at 956.

[13] *Id.* at 953 n.7 (citing the then-current version of 8 Del. Gen. Corp. L., § 141(a)).

[14] *Id.* at 953–54.

[15] *Id.*

[16] *Id.* at 957.

[17] *Id.* at 954.

nance, including issues of fundamental corporate change, a board of directors is not a passive instrumentality.''[18]

But, at the same time, the Supreme Court articulated a new standard of review to address the ''omnipresent specter'' that a board addressing a takeover bid might be ''acting primarily in its own interests, rather than those of the corporation and its shareholders.''[19] Because of ''this inherent conflict,'' the Supreme Court required a board to show: (1) that they had reasonable grounds to believe that a ''danger to corporate policy and effectiveness'' was presented by a takeover bid; and (2) that its defensive response was ''reasonable in relation to the threat posed.''[20] Only after making this affirmative showing was the board's decision entitled to the deference usually granted under the business judgment rule. Not only that, the Supreme Court stressed that it would be far easier for a board to meet this standard if it was comprised of a ''majority of outside independent directors.''[21]

The dualistic quality of the decision was also reflected in its ambivalence about the benchmark against which to evaluate a board's decision that a takeover was a threat. A threat to what? The corporation's stockholders? The corporation's workers? The community in which the corporation had traditionally been headquartered? Although the Supreme Court made clear that it intended to articulate a standard of review that would examine whether directors were ''motivated by a good faith concern for the welfare of the corporation and its stockholders,'' the Supreme Court, if anything, suggested that the interests of the corporation's stockholders were but one of many considerations a board could take into account in opposing a takeover bid.[22] Thus, the Court

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[18] *Id.*

[19] *Id.*

[20] *Id.* at 955–56.

[21] *Id.* at 955. The rejection of passivity was a direct response to certain prominent scholars who had called for boards to be passive in the face of takeover bids. *See* Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 Harv. L. Rev. 1161 (1981). But the first wave of bids involved structurally coercive bids. Thus, without board protection, stockholders faced potentially unfair treatment. Not only that, even scholars who believed that there should be a vibrant market for corporate control felt that there was a legitimate role for boards to play in generating competitive bids or negotiating for a higher price, as these activities were ones that dispersed stockholders needed a central agency to perform. *See, e.g.,* Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 Stan. L. Rev. 819 (1981); Lucian Arye Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 Harv. L. Rev. 1028, 1054–56 (1982). For these reasons, and under the strong American tradition of board-centric corporate law, the idea that directors had a role to play in addressing tender offers was readily acknowledged by the courts, leaving the key question to be how extensive the board's authority to block a bid permanently was.

[22] 493 A.2d at 955.

stated that directors responding to a takeover bid could consider the adverse ''impact'' of a bid ''on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally).''[23]

In crafting its decision in this respect, the Court cited prominently to work by Martin Lipton, a founder of Wachtell, Lipton, Rosen & Katz, who had emerged as the leading proponent of the position that corporate boards should have a free hand to reject even a takeover bid good for stockholders if the bid adversely affected other proper concerns of the corporation, including the best interests of its workers and the communities in which the corporation operated.[24] And to those who viewed this broad entrustment of authority to directors as injurious to stockholders' interests, the Supreme Court identified its view of the proper antidote: ''If the stockholders are displeased with the action of their elected representatives, the powers of corporate democracy are at their disposal to turn the board out.''[25]

By the time Chancellor Allen took office, another landmark case, the case of *Moran v. Household International, Inc.*,[26] which dealt with the validity under Delaware law of Mr. Lipton's audacious invention, the shareholder rights plan or ''poison pill,'' had already been argued in the Delaware Supreme Court. In *Moran*, the two greatest corporate lawyers of the post-war era faced off. The plaintiff challenging the validity of the pill adopted by the Household International, Inc. board was represented by Joseph Flom, who put together a litigation team from his firm to prove that the poison pill was beyond the lawful authority of the directors of a Delaware corporation. A team from Martin Lipton's firm led the defense for Household.

Astute readers of *Unocal* perceived that decision to augur well for those seeking a Delaware Supreme Court holding that the poison pill was a valid defensive device properly put in place by the Household board, and they were right. In its November 1985 decision in *Moran*, the Supreme Court cited *Unocal* in support of its holding that the statutes giving corporate boards authority to issue rights to purchase shares and preferred stock validated, as a matter of legal authority, the poison pill, irrespective of whether the drafters of those statutes would have been

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[23] *Id.*

[24] *See id.* (citing Martin Lipton & Andrew R. Brownstein, *Takeover Responses and Directors' Responsibilities: An Update* 7 in *ABA National Institute on the Dynamics of Corporate Control* (December 8, 1983)); *see also id.* at 956 n.11 (calling Lipton's important article, Martin Lipton, *Takeover Bids In The Target's Boardroom*, 35 Bus. Law. 101 (1979), a ''rather impressive study'' and generally drawing from it to shape the court's decision).

[25] *Id.* at 959.

[26] 500 A.2d 1346 (Del. 1985).

shocked by the use of them to put in place a device, the only utility of which was make it prohibitively expensive for a tender offeror to proceed with an offer to the corporation's stockholders.[27] Quoting *Unocal*, the Court reiterated that ''[o]ur corporate law is not static. It must grow and develop in response to, indeed in anticipation of, evolving concepts and needs.''[28] Consistent with *Unocal*, *Moran* gave a broad reading to the board's authority to ''manage'' the corporation's ''business and affairs,'' and therefore identified § 141(a) as ''provid[ing] the [Household] Board additional authority upon which to enact the Rights Plan.''[29] But, the Supreme Court also made clear that the board's decision to use the pill (by refusing to redeem the rights) to block an actual bid would be tested again in the heat of the contest under the newly articulated *Unocal* standard.[30]

Importantly, *Moran* echoed *Unocal* in another way. In justifying its conclusion that the poison pill was not ''much of an impediment on the tender offer process,''[31] the Supreme Court again relied upon the ability of the stockholders to solicit consents to remove the incumbent board and to seat a new board if they were dissatisfied by the use of the pill by the board in place.[32]

Moran was a major victory for Marty Lipton and others who wished to give boards a strong hand to defeat unsolicited takeover bids. But *Moran*, taken on its own terms, was not a blank check for boards. Rather, *Moran* imposed upon any board using a pill to defeat an actual tender offer the need to satisfy the *Unocal* standard. This theoretically meant that the board could find itself the subject of a judicial order requiring it to redeem the rights and allow a tender offer to proceed, because the court was not convinced that the board was acting in a reasonable, good faith way to protect legitimate corporate interests. In particular, given the extent to which major corporations were domiciled in Delaware, *Moran* suggested that the Delaware Court of Chancery would be required to decide cases that would flesh out just how different *Unocal* review was from the hands-off policy of non-review contemplated by the business judgment rule.

Later in Chancellor Allen's first year, the Supreme Court issued another landmark decision that would influence the challenges faced by Chancery in working out the practical meaning of *Unocal* and *Moran*. In

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[27] *Id.* at 1351.

[28] *Id.* (citing *Unocal*, 493 A.2d at 957).

[29] *Id.* at 1353.

[30] *Id.* at 1354.

[31] *Id.* at 1353.

[32] *Id.* at 1354.

Revlon, Inc. v. MacAndrews & Forbes,[33] Flom and Lipton tangled again, but this time Flom came out on top. In *Revlon*, the Supreme Court affirmed a Chancery decision enjoining certain deal protections the Revlon board had given its favored bidder in an auction, in order to defeat the ability of Ronald Perelman to secure control of Revlon.

The Supreme Court used the *Revlon* case to draw distinctions between two scenarios. The first was when a board was committed to its existing strategy, and was confronted with a takeover bid that it believed was inadequate in comparison to the corporation's long-term value.[34] In that circumstance, the board could use a pill to protect the corporate enterprise from being acquired or broken up. But, in an important gloss on its discussion of non-stockholder constituencies in *Unocal*, the Supreme Court made clear that even in this context, a board could only act to protect such constituencies from the impact of a takeover bid if ''rationally related benefits accru[ed] to the stockholders'' by doing so.[35] Thus, this aspect of *Revlon* seemed to make likely the future need for Chancery and the Supreme Court to determine what happened in a jump ball between a target board and its stockholders over the value of a non-coercive bid. By stripping away the ability of a board to say, for example, that a $50 bid was adequate for the stockholders but the company's workers would suffer under the bidder's management style, *Revlon* exposed the underlying issue to be this: when the directors oppose a tender offer, not because another higher valued option is or may be available, but because the board believes that the stockholders will do better by holding their shares and sharing in the benefits of the corporation's ongoing operations, who gets to decide? The stockholders by deciding whether to sell? Or the board by blocking the tender offer?

But the *Revlon* decision also outlined a second context in which a board had to act to secure the highest immediate price it could reasonably achieve. When a board had reached a decision to sell or break up the company because that was the best way to maximize value, the duty of a board changed fundamentally. Rather than being able to justify defensive measures as necessary to protect the ''corporate entity'' and its long-term wealth-generating value, a board that decided to sell or break up the company could only use defensive measures as a way of extracting the highest possible bid it could. Thus, a board could not prefer one bidder over another because that bidder's bid was better for a non-stockholder constituency (in *Revlon* itself, certain noteholders)[36] or be-

[33] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1985).

[34] *Id.* at 181–82.

[35] *Id.* at 182.

[36] This was a very stark holding. The noteholders at issue had received their notes early in the takeover battle as part of the board's initial defensive response, which involved

cause the bidder was likely to treat a non-stockholder constituency better after the takeover. ''[S]uch concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.''[37] Likewise, at the stage when a board authorized management to explore a sale because a takeover bid was clearly at a fair level, the Court said that the board no longer ''faced threats to corporate policy and effectiveness, or to the stockholders' interests, from a grossly inadequate bid.''[38] In that context, ''when bidders make relatively similar offers, or dissolution of the company becomes inevitable, the directors cannot fulfill their enhanced *Unocal* fiduciary duties by playing favorites with the contending factions. Market forces must be allowed to operate freely to bring the target's shareholders the best price available for their equity.''[39]

Marty Lipton was not pleased by his client's loss in *Revlon*, and that was understandable. *Revlon* cut back on board discretion in two related ways that Lipton opposed. First, *Revlon* made clear that even outside of the sale context, a board could only take defensive measures under *Revlon* to protect the long-term interests of stockholders. Non-stockholder constituencies were merely entitled to instrumental consideration, in the sense that their interests were only relevant to producing long-term benefits for stockholders. This conception of the business corporation as one narrowly focused on the generation of wealth for equity owners was one at odds with Lipton's beliefs. Second, by holding that getting the top price for the stockholders was the only legitimate objective of directors once they had concluded that a sale was in order, the Supreme Court narrowed the ability of a board to protect other constituencies or the corporation's legacy by preferring a bidder better for those interests, even if that bidder was offering a slightly lower price. Once in sales mode, the value the market put on the various bids to the corporation's stockholders was to be the key determinant of the winner.

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a self-tender offer in which tendering stockholders received notes with certain protections, including assurances regarding the likely trading price of the notes. Because the self-tender was only for a fixed amount of the shares, many, if not most, of the noteholders were likely still common stockholders by the time the Supreme Court decided the case. Yet, the Supreme Court held that the Revlon board could not prefer the bid of its favored white knight, Forstmann & Little, over the Perelman bid, in part because that would benefit the noteholders by providing support for the notes' value. *Id.* at 182–83. Thus, this class of noteholders went from proper objects of fiduciary concern to mere contract creditors within the space of one takeover battle.

[37] *Id.* at 182.

[38] *Id.*

[39] *Id.* at 184.

Lipton and other managerial advocates grasped the difficulties that *Revlon* presented for them. If managers reacted to a takeover by proposing a recapitalization or leveraged buy-out, they risked invocation of *Revlon* duties and a requirement to let stockholders decide. If managers reacted to a takeover bid by standing behind a poison pill, *Revlon* suggested that the managers would have to justify their continued use of the pill by reference to the best interests of stockholders, by showing that remaining independent would be better for them. But if, after the board had an adequate opportunity to elicit other bids and tell its story, a bidder was offering stockholders an all shares, all cash offer—i.e., a structurally non-coercive bid—could it use the pill to deny the stockholders the right to accept that offer? How would the Delaware courts decide that ultimate question?

The managerialists made clear that they believed that there was only one proper answer to that question and that boards should be able to just say no to a takeover. If the Delaware courts said otherwise, well then, perhaps corporate America should put on its highway shoes.

III. Delaware Under The Managerialist Microscope: The Anti–Takeover Statute Debate of 1987—1988

The takeover boom of the 1980s did not only result in increased pressure on the judicial branches of state governments. State legislatures also became embroiled in the policy debate, as corporate managers went to state legislatures looking to enact statutes that would make it difficult for hostile bidders. Marty Lipton was a leader in the effort to get state anti-takeover statutes adopted, and decisions like *Revlon* fueled his fire.

But, unlike many other states where only managerial interests had political potency and the adoption of strong anti-takeover statutes were easy bones to throw at local business interests,[40] Delaware faced a more complex political equation. Many Delaware corporations were active as bidders and had chosen Delaware in part because its law facilitated mergers and acquisitions activity. As important, contrary to certain caricatures,[41] Delaware had long prided itself on having a balanced corporate law that protected investor interests from overreaching by managers. This image as a fair broker between managers and stockholders would have been threatened by the adoption of an anti-takeover statute that stopped hostile bids in their tracks. Leading opinion journals

[40] Particularly because at this stage of the debate, labor unions threw in their lot with the managers, perceiving takeovers to threaten their own interests.

[41] The most famous of which was William L. Cary's piece, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 Yale L.J. 663, 701 (1974) (accusing Delaware of being a ''pygmy'' state leading an unprincipled, pro-manager race to the bottom).

protective of stockholder interests, such as the *Wall Street Journal*,[42] cast a gimlet eye on Delaware, suspicious that it would cave into pressure from managerialists.

Delaware therefore treaded lightly. But, after the United States Supreme Court issued its decision in *CTS Corp. v. Dynamics Corp.*,[43] upholding the constitutionality of Indiana's anti-takeover statute, Delaware's General Assembly felt compelled to adopt some form of anti-takeover statute. Unusually for a Delaware corporate law amendment, the anti-takeover statute—an amendment to § 203 of the DGCL—was the subject of a vigorous floor debate and intensive lobbying by interest groups.

Management interests threatened Delaware with an exodus of major corporations if the General Assembly did not accede to their wishes for a potent anti-takeover statute.[44] And advocates for stockholders responded by claiming that the integrity of Delaware would be called into question if it adopted a law that injured stockholders by preventing them from receiving valuable premium offers for their shares.[45] In the end, the General Assembly, with the support of Delaware's corporate bar, enacted a non-onerous anti-takeover statute that did not pose a serious barrier to any bidder willing to make an attractive, all shares offer.[46]

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[42] *See, e.g.*, Editorial, *Will Delaware Fall?*, Wall St. J., Dec. 3, 1987 (''Life is full of ironies, but we were shocked when we saw the proposed anti-takeover law for Delaware . . . here is the leading state for corporate law following its less sophisticated brethren to protect targets at the expense of bidders. . . . Revising [Delaware] law to satisfy insecure managers will make these firms less attractive to investors. . . . The mystery is why Delaware would be intimidated into passing an anti-takeover bill.'').

[43] 481 U.S. 69 (1987).

[44] The following are among the many articles detailing the heavy pressure placed on Delaware along these lines: Paul M. Barrett, *Delaware Moves Closer to Adopting Law to Deter Hostile Takeovers*, Wall St. J., Dec. 9, 1987; Editorial, *Will Delaware Fall?*, Wall St. J., Dec. 3, 1987; Doug Bandow, *Business Forum: Delaware's Takeover Law; Curbing Raiders is Bad for Business*, N.Y. Times, Feb. 7, 1988; Testimony of Secretary of State Michael E. Harkins before the Delaware House and Senate Judiciary Committees, Jan. 20, 1988, *reprinted in* Craig B. Smith & Clark W. Furlow, *Guide to the Takeover Law of Delaware* App. Q, 257–59 (1988).

[45] Among others testifying to this effect were members of the SEC and FTC, and Boone Pickens. *See* Testimony of Greg Jarrell before the Delaware Senate and House Judiciary Committees, Jan. 20, 1988, *reprinted in* Smith & Furlow, *supra* note 44, at App. Z 315–26; Letter from Joseph A. Grundfest, Commissioner of the SEC, to David Brown, Secretary of the Council of the Corporation Law Section of the Delaware State Bar Association (Dec. 10, 1987), *reprinted in* Smith & Furlow, *supra* note 44, at App. E 161–77; Editorial, *Will Delaware Fall?*, Wall St. J., Dec. 3, 1987; Paul M. Barrett, *Delaware Moves Closer to Adopting Law to Deter Hostile Takeovers*, Wall St. J., Dec. 9, 1987.

[46] *E.g.*, Dale Arthur Oesterle, *Delaware's Takeover Statute of Chills, Pills, Standstills, and Who Gets Iced*, 13 Del. J. Corp. L. 879, 879–80 (1988) (''The Delaware legislature has

Although some stockholder advocates feared that the new statute was a show stopper, the most sophisticated of the managerial advocates, Martin Lipton knew better, and made his displeasure at the weak tea clear: ''I think it is a totally meaningless measure—an ineffectual panacea that could actually make some of the takeover abuses worse.''[47] With § 203 not meeting their needs, the managerialists would be looking even more closely at what the Delaware courts did. Would they endorse just say no?

IV. Allen Agonistes: Could Chancery Forge a Coherent and Principled Common–Law Takeover Jurisprudence?

The year 1988 would turn out to be a memorable one in the development of Delaware corporate law, as Chancellor Allen confronted a rapid series of cases that gave him the chance to forge decisions that wove a predictable and principled set of standards to determine takeover disputes. The environment in which he operated was hardly settled, with the managerialists in full cry. And another element of uncertainty that Chancellor Allen faced resulted from the moralistic strain running through the Supreme Court's takeover jurisprudence. Although appellate courts are not fact finders, the Delaware Supreme Court's M & A decisions were replete with vivid characterizations of the key actors.[48] Shades of grey were eschewed for stark contrasts between those the Supreme Court believed had acted honorably and those raiders who could not be entrusted with the management of a public company and those managers who had abused the trust they owed to the corporation's stockholders.[49] The fact-specific, personally judgmental nature of this

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passed a moderated version of the New York takeover statute[, or business combination act]. . . . Various other states including Arizona, Connecticut, Georgia, Idaho, Indiana, Kentucky, Minnesota, Missouri, New Jersey, Pennsylvania, Washington, and Wisconsin have business combination acts. Of these, the Delaware provision, however, is the mildest.'') (footnotes omitted); *see also* Paul M. Barrett, *Delaware Moves Closer to Adopting Law to Deter Hostile Takeovers*, Wall St. J., Dec. 9, 1987 (" 'There had been a possibility of a change in the balance of power in takeovers,' says John Coffee Jr., a professor of corporate law at Columbia Law School who generally opposes state regulation of takeovers. He says Delaware has moved instead toward 'a deliberately and sensibly weak' law.'').

[47] Stephen Labaton, *A Debate Over the Impact of Delaware Takeover Law*, N.Y. Times, Feb. 1, 1988; Anatole Kaletsky, *Delaware Makes Its Mark On Corporate America; Takeover Legislation*, Fin. Times, Feb. 8, 1988, at 24.

[48] The Supreme Court's important decision in *Macmillan* is a good example of this sort of opinion. *See* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1989).

[49] This is not to say that these stark renderings were without utility. As a distinguished scholar has noted, these opinions had a resonance and instructive quality that goaded boards, managers, and their advisors to be more careful and more mindful of the need to constrain self-interested actors in the context of M & A transactions. *See* Edward

appellate jurisprudence, although to some extent unavoidable given that the cases involved questions of contextual fiduciary duty compliance, created some uncertainty about the direction the Supreme Court was taking, giving the cases somewhat of a yin and yang quality, with bidders and targets each having their share of victories, based as much on close factual as on rule-oriented distinctions.

Although Allen himself did not blanch from making fact findings in his jurisprudence, his recitation of the clash of interests in business cases reflected a recognition that in matters of commerce, grey was in fact the predominant color. This was not the milieu of holy men, it was the domain of successful capitalists and executives, a class that Allen knew was susceptible to the temptation to maximize its own wealth and power, and to resist suggestions at odds with its own views. But Allen's recognition of this was not condemnatory; rather it reflected an acceptance of human fallibility, and the reality that even the most honorable have moments when their self-interest may affect their behavior. In most clashes of business interests, both sides believed they were in the right, in the sense of pursuing a legitimate, ethical end.

What was most important to Allen, therefore, was to take human nature as it was, and to try to make sure that Delaware's corporate common law provided a principled and predictable basis for resolving cases in a manner that, as a general matter, helped preserve the wealth-generating benefits of the corporate form. This was most effectively done not by identifying bad actors and using them as examples, but by creating incentives to structure the approval of transactions in a manner that would tend to increase the likelihood that they were fair to stockholders.[50] Rather than erode the business judgment rule through selec-

B. Rock, *Saints and Sinners: How Does Corporate Law Work?*, 44 UCLA L. Rev. 1009 (1997) (making this argument).

[50] William T. Allen, *Keynote Address at the PLI Delaware Corporate Law Conference: Shareholder Welfare and the Eroding Business Judgment Rule* (May 11, 2005) (''The . . . law has affected director ideology . . . through its announcement of expected standards—wholly apart from liability creation. That is, most people once they understand what conduct is expected, will tend to act properly. Most of us are not the 'bad men' of the type Oliver Wendell Holmes imagined as held in check by threats of punishment. For us, the law can inspire better behavior by making its requirements known.''); *see also* William T. Allen, *Tribute to Chancellor William T. Allen*, 22 Del. J. Corp. L. 894, 898–99 (1997) (''While the appeal of the moralistic technique of opinion drafting may be strong in circumstances where community standards may be honestly portrayed as having been breached—fraud or looting by a fiduciary being paradigm business problems—I am frank to say that my opinion writing tastes typically were not satisfied with this approach as a technique for resolving questions of power in the corporate form. As I viewed these matters, more often than not, the most interesting conflicts in corporation law are engendered not by 'bad guys' seeking with guile to protect or advance private interests. The difficult and interesting questions arise from differing, but plausible, conceptions of what constitutes right action in the circumstances. So, for the interesting questions, the

tive judicial overturning of director decisions,[51] Allen's jurisprudence encouraged the development and strengthening of structural approaches designed to encourage boards to act responsibly. Thus, Allen's decisions were supportive of the creation of special negotiating committees, comprised of independent directors, to address management proposed buyouts.[52] If such committees, and their advisors, took their role seriously as the advocate for the corporation's non-affiliated stockholders, the courts could take a more hands-off approach consistent with traditional business judgment rule because disinterested fiduciaries bound by obligations of loyalty and care would be in the driver's seat.[53]

Allen's interest in structure also extended to the structures relevant to the directors' accountability to stockholders. If stockholders could protect themselves at the ballot box or by selling their stock, Delaware could credibly continue to embrace the business judgment rule and give great respect to their decisions during their term of office, particularly if case law put pressure on boards to vest more decision-making authority in their independent members.[54] Market-based discipline through the market for corporate control, and not judicial second-guessing of business judgments, was the best accountability mechanism.[55] Not only would that leave the real constituents-in-interest playing the leading role

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moralistic approach seemed, to me, essentially mistaken or at least not an attractive approach.'').

[51] *See* Solash v. Telex Corp., 1988 WL 3587, at *8 (Del. Ch. 1988) (''Because businessmen and women are correctly perceived as possessing skills, information and judgment not possessed by reviewing courts and because there is great social utility in encouraging the allocation of assets and the evaluation and assumption of economic risk by those with such skill and information, courts have long been reluctant to second-guess such decisions when they appear to have been made in good faith.'').

[52] *See, e.g.*, Freedman v. Restaurant Assocs. Indus., 1987 WL 14323, at *7 (Del. Ch. 1987).

[53] *Id.* at *8.

[54] *E.g.*, *In re* Trans World Airlines, Inc. Shareholders Litig., 1988 WL 111271, at *7 (Del. Ch. 1988) (''Both the device of the special negotiating committee of disinterested directors and the device of a merger provision requiring approval by a majority of disinterested shareholders, when properly employed, have the judicial effect of making the substantive law aspect of the business judgment rule applicable. . . .''). The Supreme Court eventually went in another direction. *See* Kahn v. Lynch Communication Systems, Inc., 638 A.2d 1110 (Del. 1994) (holding that the business judgment rule standard of review was not invoked by the use of an effective special committee of disinterested directors or a majority of the minority vote to approve a merger with a controlling stockholder); William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 Bus. Law. 1287, 1306–09 (2001) (detailing the evolution of controlling stockholder merger doctrine in Delaware).

[55] *See, e.g.*, AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 114 (Del. Ch. 1986).

in determining the final outcome, the reality that stockholders would have the final say would tend to induce more responsive board action in addressing M & A decisions, cutting down on the need for courts and even stockholders themselves to police director behavior.

But, of course, the key issue of the day was the extent to which stockholders could sell their stock to someone who made a tender offer if the directors did not favor the offer. If stockholders could not only elect their own board but freely sell their shares in tender offers, their means of self-protection would be substantial. Had the first wave of bidders in the 1980s made all-shares, all-cash premium offers, a clearer answer might have been available. But that first wave involved very different offers, ones which were often intentionally coercive.

Stockholders were poorly positioned to protect themselves from these offers, and *Unocal* and *Moran* made clear that the directors could fill the defensive breach. But *Unocal*'s and *Moran*'s decision that it was a managerial function for a board to oppose a tender offer addressed to the corporation's stockholders complicated the ability of Chancery to forge a structural approach to takeover battles that minimized the need for judicial second-guessing of board conduct. Because directors could legitimately impede certain tender offers, the looming question going into 1988 was just how far this new managerial power went and whether there were boundaries that could be set in equity that would preserve an important role for stockholder choice in whether a tender offer should be accepted.

It was only a matter of time before Chancery would have to take the first crack at an answer, and its sophisticated leader doubtless knew that when he confronted a knotty case filed by Blasius Industries, Inc. against Atlas Corporation and its incumbent directors on the penultimate day of 1987.[56]

V. Blasius: *Did the Board's "Managerial" Authority to Defend the Corporation Apply to Actions Designed to Prevent the Stockholders from Electing a New Board?*

Blasius was ideal for the sort of stark portraiture exemplified in *Unocal* and other Supreme Court decisions of the era. The plaintiff

[56] Indeed, in January 1988, Chancellor Allen issued a decision striking down a board-adopted bylaw that delayed the effectiveness of any action by written consent for 20 days after consents are first solicited so that the board could express its views on the proposal. In that decision, he noted:

> Section 228 of our corporation law, originally (in 1967) thought of [as] a statute of administrative convenience and not of great importance (*see, e.g.*, Folk, Corporation Law Developments–1969, 56 Va. L. Rev. 755, 783 (1970)) has become increasingly important as it has been utilized as a weapon in the takeover wars that have marked the current era.

Prime Computer, Inc. v. Allen, 1988 WL 5277, at *3 (Del. Ch. 1988).

Blasius Industries was controlled by two private equity novices, Michael Lubin and Warren Delano. Lubin and Delano gained control of Blasius with help from Drexel Burnham Lambert, and its high-yield or ''junk bond'' financing.[57] Lubin and Delano were experienced commercial bankers, but had only a short stint running a venture capital firm for a small investment bank before acquiring Blasius.

Once at Blasius, they sought out targets to buy in leveraged buyouts, hoping to emulate the success of other Drexel clients such as Ron Perelman. But Lubin and Delano had come up dry.[58] In May 1987, Drexel underwrote an issuance of $60 million in high-yield bonds for Blasius. Blasius's financial position was so compromised, however, that it soon was unable to meet its obligations to pay interest on the bonds from its income from operations. Blasius therefore needed a deal to stay afloat and began focusing on Atlas as the solution to its own cash flow needs.

By the time Blasius came on the scene, the board of Blasius's target, Atlas, could not be labeled a prototypical example of the sort of fat and happy directors who had allowed their company to drift into inefficient conglomerated bloat—the kind who needed a prod from an aggressive takeover bidder to unlock more stockholder value. Rather, the Atlas board was well along in restructuring efforts when Blasius came along. Atlas had retained a new CEO, Richard Weaver, in 1986. Under Weaver's leadership, Atlas quickly sold three of its five divisions. In September 1987, Atlas announced that it was shuttering its ''once important'' domestic uranium line of business. After that was done, Atlas would be a focused, easy-to-understand corporation with a single line of business—gold mining.[59]

Weaver was therefore disturbed when Blasius filed a Schedule 13D in late October revealing that it had acquired a 9.1% stake. Rather than applauding Atlas for the extensive restructuring it had undertaken, Blasius stated that ''it intended to encourage management of Atlas to consider a restructuring of the Company or other transaction to enhance shareholder values.''[60] That same filing also ''disclosed that Blasius was exploring the feasibility of obtaining control of Atlas, including instituting a tender offer or seeking 'appropriate' representation on the Atlas board of directors.''[61]

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[57] Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 653 (Del. Ch. 1988).

[58] *Id.*

[59] *Id.*

[60] *Id.*

[61] *Id.*

Weaver huddled with advisors, including Goldman Sachs which had been advising the company in connection with its restructuring, to figure out how to address Blasius. Weaver crafted an indiscreet diary entry recounting his desire to ''dilute these people down by the acquisition of another Co. w/stock, or merger or something else.''[62] In his typically understated but yet pointed way, Chancellor Allen chalked this infelicity down to ''Mr. Weaver . . . perhaps thinking that the restructuring that had occurred should be given a chance to produce benefit before another restructuring . . . was attempted.''[63]

Blasius asked for a meeting and Atlas stalled, but eventually assented. At the meeting, it became clear that Blasius had no operational restructuring plans. All that Blasius wanted to do was to leverage up Atlas, by using the cash generated by the previous division sales and the upcoming sale of the uranium business and the proceeds from taking out a loan of over $35 million secured by gold owned by the company to pay out a huge dividend comprised of $35 million in cash and $125 million in high-yield debentures.[64] After Atlas had made those payouts, it would have a huge debt burden.

After Atlas put out a press release casting severe doubt on the viability of Blasius's plan and told Lubin that any follow-up meeting would have to await the completion of an analysis of Blasius's plan by Goldman Sachs, Blasius commenced a consent solicitation seeking consents to: (1) adopt a precatory resolution recommending that the Atlas board consider a leveraged recapitalization along the lines Blasius had proposed; (2) amend the Atlas by-laws to expand the size of the board from seven to fifteen members, the maximum permissible under the company's certificate of incorporation; and (3) elect eight designated candidates to fill the new seats. If successful, Blasius would have elected a new board majority. The same day Blasius filed a lawsuit in the Delaware Court of Chancery attacking certain bylaw provisions Atlas had adopted in September.

Blasius's strike exploited a vulnerability in Atlas's defensive armor. Atlas's certificate of incorporation called for a classified board. The most obvious purpose of a classified board is to prevent any single election from changing a majority of the board. If a classified board works effectively, an insurgent can only get a third of the board at a bite, and must either convince the incumbent board majority to go in her direction, or persevere and succeed in yet another election, until she can secure a board majority. But the Atlas board had not received regular

[62] *Id.*

[63] *Id.*

[64] *Id.* at 654.

check-ups on its corporate governance instruments, and was a ''wounded bird.''[65]

Because the Atlas certificate and bylaws permitted the board size to be increased to 15 by a stockholder-adopted bylaw, the classified board could not prevent Blasius from electing a new board majority in a consent solicitation. The chagrin Atlas CEO Weaver and his advisors must have felt after receiving Blasius's December 30 written consent was undoubtedly amplified by the reality that by then they had already begun to take steps to heal the wounded bird.

In early December, Weaver had begun to consider using the board's authority to amend the bylaws to increase the size of the board from seven to eight, and to appoint a new member to fill the new seat. On Christmas Eve, Weaver sent the board the resume of Harry J. Winters, with a recommendation that he would propose that the board be expanded at the January 6 meeting and that Winters be appointed. Winters was a high-quality candidate who was an expert in mining economics. Weaver had discussed Winters joining the Atlas board in autumn 1986 early in Weaver's tenure as CEO, but Weaver had not acted further on the idea until December 7, 1987. By that time, the threat that Blasius would launch a consent solicitation was palpable.

When Blasius launched its consent solicitation, Weaver and his advisors sped up and intensified their plans for changing the Atlas board. Rather than simply add Winters, Weaver also proposed adding John M. Devaney, a financial executive employed by Atlas, thereby increasing the size of the Atlas board to nine. Because Devaney and Winters would be seated for terms of one and three years respectively, Blasius could not elect a new board majority through its consent solicitation, as it would only have 6 seats out of 15 to fill. An emergency meeting of the Atlas board was held on December 31 and Winters and Devaney were seated. The meeting was held on December 31 because Atlas's counsel feared that if it did not act immediately, Blasius might obtain an injunction in Chancery preventing the board from increasing its membership until the consent solicitation was completed. Under the Atlas certificate and bylaws, the Atlas board was within its authority to increase the size of the board and to appoint Winters and Devaney to the terms they received.

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[65] *See* Leo E. Strine, Jr., *If Corporate Action Is Lawful, Presumably There Are Circumstances in Which It Is Equitable to Take That Action: The Implicit Corollary to the Rule of* Schnell v. Chris–Craft, 60 Bus. Law. 877, 890 n.55 (2005) (''Under the 'wounded bird' theory Vice Chancellor Stephen P. Lamb coined and the two of us have often discussed, corporate law cases often involve situations when directors, by failing to heal the wounded bird before hunting season, must stand before the hunter defenseless, because once hunting season starts, healing action that would otherwise be permitted is often deemed improper.'').

On January 6, 1988, the Atlas board met again to hear formally from Goldman Sachs regarding its views of Blasius's leveraged recapitalization proposal. Chancellor Allen summarized Goldman's assessment as follows:

> [I]f Atlas implemented the Blasius restructuring proposal (i) a severe drain on operating cash flow would result, (ii) Atlas would be unable to service its long-term debt and could end up in bankruptcy, (iii) the common stock of Atlas would have little or no value, and (iv) since Atlas would be unable to generate sufficient cash to service its debt, the debentures contemplated to be issued in the proposed restructuring could have a value of only 20% to 30% of their face amount. Goldman Sachs also said that it knew of no financial restructuring that had been undertaken by a company where the company had no chance of repaying its debt, which, in its judgment, would be Atlas' situation if it implemented the Blasius restructuring proposal. Finally, Goldman Sachs noted that if Atlas made a meaningful commercial discovery of gold after implementation of the Blasius restructuring proposal, Atlas would not have the resources to develop the discovery.[66]

After hearing from Goldman, the Atlas board voted to reject Blasius's proposal and Blasius was promptly informed of that decision.

Blasius then launched a modified consent solicitation that took into account the Atlas board's appointment of Winters and Devaney. Blasius sought to remove them from their seats and to elect eight new directors. Thus, the modified consent solicitation's success turned on Blasius's ability to convince the Court of Chancery that Winters and Devaney were seated improperly. Unless that was the case, Blasius had a weak case that it could remove Winters and Devaney—members of a classified board—without cause.[67]

At the conclusion of Blasius's consent solicitation, the independent inspector of the election found that Blasius's proposals had failed by a narrow margin. Blasius therefore brought another suit contesting the results of the proxy contest over the consent solicitation. Both of Blasius's suits were tried together.

In his post-trial opinion, Chancellor Allen divided his analysis into two parts. The first part is famous and dealt with the question of whether Winters and Devaney were properly appointed. The second is often forgotten and dealt with the question of whether Blasius had succeeded in having the official vote count altered in a manner that

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[66] 564 A.2d at 657.

[67] 8 Del. Gen. Corp. L., 141(k)(1) (''[I]n the case of a corporation whose board is classified . . . shareholders may [remove any director or the entire board] only for cause.'').

would give it the necessary votes to have succeeded in its consent solicitation. Importantly, Chancellor Allen ruled for Atlas in that second part and upheld the inspector's determination that all of Blasius's initiatives had failed to get the required number of votes, including the initiatives to remove Winters and Devaney and to elect eight new directors. Thus, when Chancellor Allen issued his famous first half of his decision, he realized that, absent appellate reversal on a factual issue relating to vote counting (a rarity in corporate jurisprudence), his decision regarding the propriety of Winters' and Devaney's appointment would not have the effect of turning over control of Atlas to Blasius. Although it would be unjust and inappropriate to suggest that Chancellor Allen's resolution of the Winters–Devaney issue would have been different had the outcome of the fight for control actually turned primarily on that issue, one senses that it gave him some psychic comfort that his ruling was not working harm.

Why do I say so? Because of the reasoning of the first part of the opinion itself. Although Chancellor Allen was ruling for Blasius on the Winters–Devaney issue, he made no attempt to slant the facts in Blasius's direction. Indeed, in his own subtle way, Chancellor Allen made patent that this was a struggle that was starker than the one in *Unocal*. Blasius was an insolvent entity desperate for a financial gimmick that would make it a winner, even if that gimmick was not sustainable in the long-term, a party certainly no better than T. Boone Pickens. And Atlas was a company that had already undertaken aggressive plans to restructure and unlock stockholder value, and simply sought to pursue its new business plan; unlike Unocal, it did not respond to Blasius's overture by changing direction. Instead, it stuck to its guns.

Chancellor Allen did not sugarcoat these realities, but they did not influence his determination of the Winters–Devaney issue. It is easy to imagine a trial judge, picking up on the music of *Unocal*, crafting a stark good versus evil parable and upholding the Atlas board's actions as a noble defense of the corporate bastion against rude, uncivilized barbarians. Allen forewent this approach. Yet, in ruling in the other direction, Chancellor Allen eschewed another obvious option. In deciding whether the Atlas board had acted properly in appointing Winters and Devaney, Chancellor Allen could have taken the easy route of concluding that the Atlas incumbents were acting to entrench themselves by preventing a change of control that could have threatened Weaver's managerial tenure. Weaver's diary entry gave Allen evidence to support such an inference. But Allen did no such thing.

To the contrary, while acknowledging that the Atlas board understood that the appointment of the new directors precluded a majority of the Company's shareholders from placing a majority of new directors on the board through Blasius's consent solicitation, Chancellor Allen found

that they believed they were acting in the best interest of [Atlas] ''in a good faith effort to protect its incumbency, not selfishly, but in order to thwart implementation of the recapitalization that it feared, reasonably, would cause great injury to [Atlas].''[68] Chancellor Allen found the board's view to be justified, and noted that he, too, was ''inclined to think [that the Blasius leveraged recapitalization concept] was not a sound proposal.''[69] Stated differently, he found that the board's primary motivation in adding two new members was not to keep their jobs;[70] it was to prevent the election of a new majority so as to thwart Blasius's ''impractical'' and ''dangerous'' recapitalization plan.[71] For these reasons, Chancellor Allen concluded that he could not use the teaching of *Schnell v. Chris–Craft Industries, Inc.,*[72] to set aside the appointments of Winters and Devaney, because in his view that case only allowed equity to set aside lawful director action when the directors had used their legal powers for a bad faith, and thus inequitable, purpose.[73]

Chancellor Allen also did not dispute the qualifications of the board's two new appointees. He did not doubt that they were ''sensible and prudent'' choices who would ''strengthen[] the Atlas board,''[74] and that ''the addition of these qualified men would, under other circumstances, be clearly appropriate as an independent step.''[75] The problem, though, was that the board's action had the intended, rather than

[68] 564 A.2d at 658.

[69] *Id.* at 663.

[70] *Id.* at 656.

[71] *Id.* at 658.

[72] 285 A.2d 437 (Del. 1971). In *Schnell v. Chris–Craft*, the Delaware Supreme Court held that certain lawful actions taken for the purpose of frustrating the ability of stockholders to wage an effective proxy contest were inequitable. After concluding that the motivation of the board was to entrench themselves by impeding the insurgents' chance to fairly present their case to the stockholders, the Supreme Court gave the back of the hand to the argument that they could do so as long as the board was within its legal authority under the Delaware General Corporate Law and the corporation's charter and bylaws.

[73] 564 A.2d at 657 (interpreting *Schnell* as standing for the proposition ''that directors hold legal powers subjected to a supervening duty to exercise such powers in good faith pursuit of what they reasonably believe to be in the corporation's interest''); *id.* at 658 (*Schnell* would have supported ruling for Blasius if the Atlas board's concerns about Blasius's leveraged recapitalization were simply pretexts for entrenchment motivations).

[74] *Id.* at 655.

[75] *Id.* at 656. Chancellor Allen's determination that the board's principal motivation was to interfere with the shareholder vote is critical to his analysis: ''If the board in fact was not so motivated, but rather had taken action completely independently of the consent solicitation, which merely had an incidental impact upon the possible effectuation of any action authorized by the shareholders, it is very unlikely that such action would be subject to judicial nullification.'' *Id.* at 655.

incidental, consequence of ''interfering with the effectiveness of a stockholder vote,''[76] because it ''impede[d] or preclude[d] a majority of the shareholders from effectively adopting the course proposed by Blasius.''[77] That circumstance, the Chancellor found, implicated considerations that took the directors out from under the protective framework of the business judgment rule.

In so finding, Chancellor Allen acknowledged that *Unocal* had held that defensive actions that were taken as a good faith and proportionate response to a takeover bid were equitable, even if they had an entrenchment effect. He therefore asked: ''Does this rule—that the reasonable exercise of good faith and due care generally validates, in equity, the exercise of legal authority even if the act has an entrenchment effect—apply to action designed for the primary purpose of interfering with the effectiveness of a stockholder vote?''[78] His answer was a resounding no: ''Our authorities, as well as sound principles, suggest that the central importance of the franchise to the scheme of corporate governance, requires that, in this setting, that rule not be applied and that closer scrutiny be accorded to such transaction.''[79]

Chancellor Allen then explained his answer, in two basic parts. The first addressed the underlying issue of legitimacy of director authority:

> The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests. *Generally, shareholders have only two protections against perceived inadequate business performance. They may sell their stock . . . or they may vote to replace incumbent board members.*
>
> It has, for a long time, been conventional to dismiss the stockholder vote as a vestige or ritual of little practical importance. It may be that we are now witnessing the emergence of new institutional voices and arrangements that will make the stockholder vote a less predictable affair than it has been. Be that as it may . . . the vote . . . is critical to the theory that legitimates the exercise of power by some (directors and officers) over vast aggregations of property that they do not own. Thus, when viewed from a broad, institutional perspective, it can be seen that matters involving the integrity of the shareholder voting process involve consideration[s] not present in any other context in which directors exercise delegated power.[80]

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[76] *Id.* at 659.

[77] *Id.* at 656.

[78] *Id.* at 659.

[79] *Id.*

[80] *Id.* (emphasis added)(footnote omitted).

Chancellor Allen then turned to answering a categorical question he had set out a bit earlier:

> The real question the case presents . . . is whether, in these circumstances, the board, even if it *is* acting with subjective good faith (which will typically, if not always, be a contestable or debatable judicial conclusion), may validly act for the principal purpose of preventing the shareholders from electing a majority of new directors. The question thus posed is not one of intentional wrong (or even negligence), but one of authority *as between the fiduciary and the beneficiary* (not simply legal authority, *i.e.*, as between the fiduciary and the world at large).[81]

In answering his own question, Chancellor Allen attempted to explain why legally authorized director action affecting shareholder voting should be categorically distinct from other legally authorized director action, and therefore outside the ambit of the business judgment rule:

> The distinctive nature of the shareholder franchise context also appears when the matter is viewed from a . . . doctrinal point of view. From this point of view . . . it appears that the ordinary considerations to which the business judgment rule originally responded are simply not present in the shareholder voting context. That is, a decision by the board to act for the primary purpose of preventing the effectiveness of a shareholder vote inevitably involves the question who, as between the principal and the agent, has authority with respect to a matter of internal corporate governance.[82]

Chancellor Allen then used his next sentences to make clear that he was speaking to a variety of potential cases, but especially to a situation when the directors were acting to prevent their own replacement:

> *That, of course, is true in a very specific way in this case which deals with the question who should constitute the board of directors of the corporation*, but it will be true in every instance in which an incumbent board seeks to thwart a shareholder majority. *A board's decision to act to prevent the shareholders from creating a majority of new board positions and filling them does not involve the exercise of the corporation's power over its property, or with respect to its rights or obligations; rather, it involves allocation, between shareholders as a class and the board, of effective power with respect to governance of the corporation.* This need not be the case with respect to other forms of corporate action that may have an entrenchment effect—

[81] *Id.* at 658–59 (footnote omitted).

[82] *Id.* at 659–60.

> such as the stock buyback[] present in *Unocal*. . . . Action designed principally to interfere with the effectiveness of a vote inevitably involves a conflict between the board and a shareholder majority. Judicial review of such action involves a determination of the legal and equitable obligations of an agent towards his principal. This is not, in my opinion, a question that a court may leave to the agent finally to decide so long as he does so honestly and competently; that is, it may not be left to the agent's business judgment.[83]

Having created a category of cases distinct from the reach of either the business judgment standard of review or even the heightened *Unocal* standard, the Chancellor then had to determine what metric to apply to boards who ''acted for the primary purpose of thwarting the exercise of a shareholder vote.''[84]

Despite his own words, which heavily freighted the circumstances in which the standard would be invoked, Chancellor Allen eschewed a *per se* standard of impropriety, in favor of a stringent standard requiring the defendants to ''demonstrat[e] a compelling justification'' for their actions.[85] Thus, although Chancellor Allen had framed his analysis as one about authority, his holding did not embrace the notion that the directors were without authority to act, but that they were exercising a delegated power so infected with the potential for misuse that it should be subjected to withering judicial scrutiny.[86]

He then applied that standard and concluded that the Atlas defendants had not met it:

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

[83] *Id.* at 660 (emphasis added).

[84] *Id.*

[85] *Id.* at 661.

[86] *Id.* at 659. As I have pointed out elsewhere, the compelling justification test echoes the severe standard used in First Amendment political speech restriction and Fourteenth Amendment racial classification cases, a standard that defendants almost never survive. *See* Mercier v. Inter–Tel (Delaware), Inc., 929 A.2d 786, 806 (Del. Ch. 2007); Leo E. Strine, Jr., *supra* note 65, at 892.

> *should comprise the board of directors*. The theory of our corporation law confers power upon directors as the agents of the shareholders; it does not create Platonic masters. It may be that the Blasius restructuring proposal was or is unrealistic and would lead to injury to the corporation and its shareholders if pursued. Having heard the evidence, I am inclined to think it was not a sound proposal. The board certainly viewed it that way, and that view, held in good faith, entitled the board to take certain steps to evade the risk it perceived. It could, for example, expend corporate funds to inform shareholders and seek to bring them to a similar point of view. But there is a vast difference between expending corporate funds to inform the electorate and exercising power for the primary purpose of foreclosing effective shareholder action. A majority of the shareholders, who were not dominated in any respect, could view the matter differently than did the board. If they do, or did, they are entitled to employ the mechanisms provided by the corporation law and the Atlas certificate of incorporation to advance that view. . . .
>
> I therefore conclude that, even finding the action taken was taken in good faith, it constituted an unintended violation of the duty of loyalty that the board owed to the shareholders.[87]

Close analysis of the reasoning of *Blasius* is important. In fact, the opinion's stirring invocation of democratic principles often sends law students and other readers into a patriotic rapture of sorts, rendering them unable to dig deeper and to explore the full doctrinal implications of and, as important, understand the limitations of Chancellor Allen's important decision. Most important for present purposes, it is through a close look at the language and reasoning of *Blasius* that one can best grasp how influenced that decision was by the larger doctrinal debate about board authority and stockholder choice being addressed to the Delaware Court of Chancery and Delaware Supreme Court.

Let us begin with the strange notion that the ultimate holding in *Blasius* was rooted in a division of authority. On formal grounds, that is hard to justify. Although the decision says little about the board's authority to expand its membership and to seat Winters and Devaney for extended terms, that authority existed. Indeed, to the extent that *Blasius* was rooted in analogies to republican democracy and constitutional theory, it avoided considering some confounding facts.

For starters, the equivalent of the corporate constitution—the certificate of incorporation—called for a staggered board. Had that constitutional structure been correctly implemented, Blasius would not have had a chance to elect a new board majority at one time. Only the lack of attention to the certificate's maintenance gave Blasius an opening. Nor

[87] 564 A.2d at 662–63 (citations omitted) (emphasis added).

did the corporate charter or the bylaws give the Atlas stockholders any right to call an election for a board majority. To the contrary, the board had the authority itself to expand the size of the board to the limits set forth in the charter and to fill the new seats with appointees of its choosing.

Thus, premising a decision on whether it was proper for the Atlas board to seat Winters and Devaney in authority terms was harder than it was for the Supreme Court to find in *Unocal* and *Moran* that defending against a tender offer addressed to stockholders was managing the corporation. The express terms of the Atlas certificate and bylaws answered the authority question in the directors' favor, in a way that § 141(a) and other Delaware statutes did not as to the question of director authority to impede tender offers.

Chancellor Allen undoubtedly knew this. Which may be why although he readily assumed that the board had the legal authority to act as it did, he did not make more express how extensive and explicit that authority was. In particular, he never considered the reality that the directors were in fact restoring the board to the sort of electoral security that the corporate constitution actually contemplated and what the implications were of that hard fact.

What he did instead was to treat the domain of equity as almost entirely independent of law, at least insofar as law acting as a source of director authority, and to consider the authority question almost as if he were writing on a clean slate. I caveat the independence notion because Chancellor Allen drew importantly on the statutory rights of stockholders to use the written consent process to effect corporate governance changes and to elect new directors and the contractual rights of the Atlas stockholders to pass bylaws addressing the size of the board. But, once the stockholders' side of the legal authority equation was considered, law essentially went out of the analysis.

To ground his decision in authority terms, Chancellor Allen also addressed the Atlas board's ''primary purpose'' in a fascinating way. The word ''purpose'' is often used to describe the ultimate end that is the objective of an action.[88] In his decision, Chancellor Allen was careful to credit the Atlas board with a high-minded motivation: their ultimate end was not to preserve themselves in office, rather it was to protect the company's stockholders from ruin by a reckless leveraged recapitalization plan. Indeed, it was precisely because the primary purpose of the

[88] *See, e.g.*, *Webster's Ninth New Collegiate Dictionary* 957 (1988) (defining purpose as ''something set up as an object or end to be attained''); *American Heritage Dictionary of the English Language* 1423 (4th ed. 2000) (defining purpose as ''the object toward which one strives'' and ''[a] result or effect that is intended or desired''); *Black's Law Dictionary* 1271 (8th ed. 2004) (defining purpose as ''[a]n objective, goal, or end'').

Atlas board was not entrenchment, but the best interests of the stockholders, that Chancellor Allen did not use a more traditional analysis to condemn the appointment of Winters and Devaney.[89]

But when it came time to frame his analysis of the respective authority of the Atlas board and the company's stockholders, Chancellor Allen employed a more instrumentally focused conception of purpose. Rather than being the ultimate objective being sought by the Atlas board, primary purpose now referred to the intended effect of the seating of Winters and Devaney on the ability of Atlas stockholders to elect a new board. If the only justification for director action was to preclude stockholders from electing a new board that might take a different view of a disputed policy matter, that action was for the primary purpose of ''thwarting a shareholder majority'' and subject to stringent scrutiny. That the board was in fact motivated by a belief that its continuation in power would be more beneficial to stockholders than if a new board was elected did not change the purpose of the board action. The purpose in terms of intended impact was to deprive the stockholders of their ability to elect new directors.

It was this reasoning that established the categorical boundary in equity that Chancellor Allen was seeking to mark out. If the singular purpose for an action affecting the electoral process was the desire of the incumbents to prevent the stockholders from electing a new board that might take a different view of a policy matter, then the directors had taken action categorically different than a business judgment. While in office, directors were free to take a myriad of business decisions that stockholders might not favor. But what directors were not free to do was to decide that stockholders had to be protected from themselves, by impairing their ability to choose a new set of directors to manage the company.

Thus, even though the Atlas board had a good faith basis to believe that the election of the Blasius slate would lead to adverse outcomes for stockholders, Chancellor Allen held that it was inequitable for them to use preclusive means to prevent the stockholders from choosing to seat the Blasius slate. Importantly, he made clear that they could use other,

[89] *Blasius*, 564 A.2d at 658–59, 663 (concluding that because the Atlas board acted in good faith to protect stockholders and not to entrench themselves, that *Schnell* did not bar the seating of Winters and Devaney). There is a line of cases holding that director action taken for the primary purpose of entrenchment should be set aside in equity. *See, e.g.*, Yasik v. Wachtel, 17 A.2d 309, 312 (Del. Ch. 1941) (''It is a breach of [directors' fiduciary] dut[ies] . . . to [take action] to accomplish an improper purpose, such as to enable a particular person or group to maintain or obtain voting control, against the objection of shareholders from whom control is thereby wrested.'') (citing cases); Cheff v. Mathes, 199 A.2d 548, 554 (Del. 1964) (''[I]f the board has acted solely or primarily because of the desire to perpetuate themselves in office, the use of corporate funds for such purposes is improper.'').

less drastic means to protect them. By way of example, he noted that the board was free to inform the stockholders of its view of the merits of Blasius's leveraged recapitalization proposal, and to expend corporate funds for that purpose.[90] He also clearly implied that the board would also be able to take reasonable delaying action, if necessary to ensure that the electorate could make an informed decision.[91] But, in the end, the stockholders had to have the chance to decide for themselves whether to seat the new Blasius majority.

VI. Can A Board "Just Say No" Forever To An All Cash, All Shares Offer?: Interco *Suggests Not*

Two days after the *Blasius* decision, another case—*City Capital Associates Limited Partnership v. Interco Inc.*[92]—landed on Chancellor Allen's desk. *Interco*, as the case came to be called, was the case Allen knew was coming sometime, the case that would begin to determine the extent to which a board of directors could use a poison pill to block a non-coercive tender offer. Or in other words, just how far could boards intrude on the stockholders ability to protect themselves by choosing to sell their stock?

The facts of *Interco* are complex, but the essential story goes like this. City Capital, led by the Rales Brothers, made an all cash, all shares tender offer to acquire all the shares of Interco Inc. Interco's name was a perfect description of its basic nature, as a conglomerate of disparate businesses that had virtually no operational or other synergies. City Capital's bid rose from $64 per share, to $70 per share, and ultimately to $74. By the time of City Capital's request to enjoin the use of the pill against its ultimate $74 offer, Interco had adequate time to seek out other suitors but did not go that route and none emerged on their own.

What Interco did do was to come up with its own leverage recapitalization proposal. That proposal involved Interco selling a substantial amount of its assets and taking on over $2 billion in debt to make a special dividend to its stockholders. The special dividend was comprised of $49 in two successive cash payments and a combination of debentures and preferred stock supposedly worth another $17 per share, for a total of $66. According to Interco's investment banker, the remaining equity

[90] 564 A.2d at 663.

[91] *Id.* at 662–63 (emphasizing that the Atlas board had adequate time to tell its story and understood that it had such time when it appointed Winters and Devaney); *see also* Stahl v. Apple Bancorp, Inc., 579 A.2d 1115, 1124 (Del. Ch. 1990) (subsequent Chancellor Allen decision permitting a board to delay a corporate election in order to ensure that the electorate was adequately informed about what would result if the insurgents won the election, namely that a tender offer was tied to the proxy contest).

[92] 551 A.2d 787 (Del. Ch. 1988).

stub interest would trade at $10 per share. Thus, Interco argued that its recapitalization proposal was worth $76 per share, $2 more than City Capital's $74 offer. But the equity markets did not see it that way, and Interco's shares were trading at only $70 per share as the matter was put to Chancellor Allen.

City Capital sought broad injunctive relief. Not only did it want use of the poison pill enjoined, it wanted the court to enjoin Interco from taking any steps in furtherance of its own recapitalization plan, including from selling the important Ethan Allen division or making a special cash dividend. Consistent with his reasoning in *Blasius*, Chancellor Allen carefully distinguished between those board decisions that involved active management of the business of the corporation and those that simply precluded stockholders from deciding for themselves whether to sell their stock in response to a non-coercive offer.

Therefore, he refused to enjoin the Interco board from selling Ethan Allen or issuing a cash dividend. Because the board was selling Ethan Allen in an open, competitive process in which City Capital could participate, it was acting consistently with its fiduciary duties by maximizing the value of a company asset.[93] Moreover, Chancellor Allen could find no fault with a return of cash to the stockholders. Neither of these options precluded any ultimate bid by City Capital, which, Chancellor Allen held, had no right to insist that Interco remain in stasis until its offer could be accepted.[94] Equally important, as an overall matter, Chancellor Allen held that the mere fact that City Capital made a bid did not impose on the Interco board the duty to sell the company in an auction. Rather, if the board believed in good faith that a leveraged recapitalization would be more beneficial to stockholders than an auction sale, *Revlon* did not stand in its way, and the key question was whether the recapitalization alternative was an unreasonable defensive response under *Unocal*.[95] In all these respects, *Interco* strongly reinforced the wide range of discretion *Unocal* emphasized that directors had to respond to takeover bids.

But in the more famous part of the decision, Chancellor Allen rejected the Interco board's use of the pill to deny its stockholders the chance to choose City Capital's $74 offer instead of the restructuring favored by management. His reasoning was straightforward. Because the City Capital offer was structurally non-coercive, there was no threat that stockholders would have no effective choice. Because the Interco board had been afforded the chance to bargain with City Capital, to develop

[93] *Id.* at 801.

[94] *Id.*

[95] *Id.* at 802.

other bids, to generate its own alternative, and to inform stockholders of its view about the relative merits of the City Capital offer and its own alternative, the poison pill had exhausted its legitimate utility. At the stage the case came to Chancellor Allen, the only threat was that stockholders would conclude that the $74 City Capital offer was better for them than the Interco board's own restructuring proposal, which it valued at $76, but which did not involve cash on the barrel head immediately.

Chancellor Allen made clear that in his view this sort of threat only justified provisional use of the pill:

> *In this instance, there is no threat of shareholder coercion. The threat is to shareholders' economic interests posed by an offer the board has concluded is ''inadequate.''* If this determination is made in good faith (as I assume it is here), it alone will justify leaving a poison pill in place, even in the setting of a noncoercive offer, for a period while the board exercises its good faith business judgment to take such steps as it deems appropriate to protect and advance shareholder interests in light of the significant development that such an offer doubtless is. That action may entail negotiation on behalf of shareholders with the offeror, the institution of a *Revlon*-style auction for the Company, a recapitalization or restructuring designed as an alternative to the offer, or other action.
>
> Once that period has closed, and it is apparent that the board does not intend to institute a *Revlon*-style auction, or to negotiate for an increase in the unwanted offer, and that it has taken such time as it required in good faith to arrange an alternative value-maximizing transaction, then, in most instances, the legitimate role of the poison pill in the context of a noncoercive offer will have been fully satisfied. *The only function then left for the pill at this end-stage is to preclude the shareholders from exercising a judgment about their own interests that differs from the judgment of the directors, who will have some interest in the question. What then is the ''threat'' in this instance that might justify such a result? Stating that ''threat'' at this stage of the process most specifically, it is this: Wasserstein Perella* [Interco's advisor] *may be correct in their respective valuations of the offer and the restructuring but a majority of the Interco shareholders may not accept that fact and may be injured as a consequence.*
>
> Perhaps there is a case in which it is appropriate for a board of directors to in effect permanently foreclose their shareholders from accepting a noncoercive offer for their stock by utilization of the recent innovation of ''poison pill'' rights. If such a case might exist by reason of some special circumstance, a review of the facts here

> show this not to be it. The ''threat'' here, when viewed with particularity, is far too mild to justify such a step in this instance.[96]

In so finding, Chancellor Allen explicitly avoided any determination of which alternative was better for Interco stockholders, stating:

> The point here is not that, in exercising some restrained substantive review of the board's decision to leave the pill in place, the court finds [CCA's advisor] Drexel's opinion more persuasive than [Interco's advisor] Wasserstein Perella's. I make no such judgment. What is apparent—indeed inarguable—is that one could do so. More importantly, without access to Drexel Burnham's particular analysis, a shareholder could prefer a $74 cash payment now to the complex future consideration offered through the restructuring. The defendants understand this; it is evident. . . .
>
> Yet, recognizing the relative closeness of the values and the impossibility of knowing what the stub share will trade at, the board, having arranged a value maximizing restructuring, elected to preclude shareholder choice. It did so not to buy time in order to negotiate or arrange possible alternatives, but asserting in effect a right and duty to save shareholders from the consequences of the choice they might make, if permitted to choose.
>
> Without wishing to cast any shadow upon the subjective motivation of the individual defendants, I conclude that reasonable minds not affected by an inherent, entrenched interest in the matter, could not reasonably differ with respect to the conclusion that the CCA $74 cash offer did not represent a threat to shareholder interests sufficient in the circumstances to justify, in effect, foreclosing shareholders from electing to accept that offer.
>
> Our corporation law exists, not as an isolated body of rules and principles, but rather in a historical setting and as a part of a larger body of law premised upon shared values. *To acknowledge that directors may employ the recent innovation of ''poison pills'' to deprive shareholders of the ability effectively to choose to accept a noncoercive offer, after the board has had a reasonable opportunity to explore or create alternatives, or attempt to negotiate on the shareholders' behalf, would, it seems to me, be so inconsistent with widely shared notions of appropriate corporate governance as to threaten to diminish the legitimacy and authority of our corporation law.*[97]

In this reasoning, Chancellor Allen deviated in an important way from the recommendations of scholars who he respected and cited in *Interco*. By the time *Interco* was decided, many scholars were concerned

[96] *Id.* at 798 (emphasis added)(footnotes omitted).

[97] *Id.* at 799–800 (emphasis added).

that the new *Unocal* standard would devolve into a toothless one, easy to satisfy by any board that added a dollop of extra procedure to the usual effort, a glorified form of business judgment rule review that would let managers impede takeovers valuable to stockholders. In that camp were Professors Gilson and Kraakman, who crafted an article designed to put backbone in courts employing *Unocal*.[98]

But in that article, the professors articulated a concept that they styled ''substantive coercion'' to characterize offers that were not structurally coercive but that were perceived by a target board to be financially inadequate. Substantive coercion supposedly rested in the proposition that stockholders might be wrong in rejecting the board's advice that a tender offer was not adequately priced in view of the corporation's future earnings potential.[99] Recognizing the dangers that this sort of argument—that the stockholders should be protected from themselves—posed, Gilson and Kraakman nonetheless assumed that courts would give boards some leeway to make these arguments. They then addressed the concern that boards would abuse their authority by suggesting that if the only threat an offer posed was of ''substantive coercion,'' the court should hold a detailed inquiry into the economics of the board's position, and force the board to show that its plans for the corporation would deliver more value to stockholders than the tender offer.[100] Only if the board met this burden of persuasion could the pill be used to block the bid.

Despite citing the unpublished version of this article in a favorable way,[101] Chancellor Allen clearly avoided any reliance on this part of the article and its association of the word ''coercion'' with a cash bid that was for all shares. Rather, *Interco* suggested that the ultimate decision about whether a non-coercive tender offer should be accepted was to be left to stockholders. Directors could not block that ultimate say, and it was decidedly not the job of the court to opine on the economic merits. Rather, once the board had been given time to generate a higher-valued alternative and to make its views of the merits clear, an unconditional,

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[98] Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 Bus. Law. 247 (1989).

[99] *Id.* at 259–60.

[100] *Id.* at 267–68.

[101] *See Interco*, 551 A.2d at 796 n.8 (citing the working paper version of Ronald Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to the Proportionality Review?*, 44 Bus. Law. 247 (1989)) (''Professors Gilson and Kraakman offer a helpful structure for reviewing problems of this type and conclude with a perceptive observation concerning the beneficial impact upon corporate culture that the *Unocal* test might come to have.'').

non-coercive offer directed to stockholders was one that they were entitled to accept or reject for themselves.

In so ruling, Chancellor Allen's words echoed key parts of *Blasius* and reflected a judgment that stockholders were mature adults entitled to be treated as such.[102] When the law gave them, rather than the board, decision making authority, it was not to be usurped by paternalistic directors, even ones acting in good faith. Could a board ''just say no,'' and prevent stockholders from deciding whether to accept an unconditional, all shares, all cash tender offer? *Interco* seemed to say nay.

The Interco board took an appeal, and observers were anxious to see what the Delaware Supreme Court would have to say. But City Capital dropped its bid and Chancellor Allen's decision stood as precedent for the meantime.

Then Marty Lipton roared. He sent out a client memorandum encouraging clients to consider leaving Delaware and reincorporating in another state where management had a stronger hand to defeat takeovers, calling *Interco* a ''dagger aimed at the hearts of all Delaware corporations and a further fueling of the takeover frenzy.''[103] He did not get any happier when retired Supreme Court Justice William Duffy issued another pill decision in December 1988, citing the reasoning of *Interco* with favor and requiring Pillsbury to lift its pill and let an offer by Grand Met proceed.[104]

Referring to *Interco* and *Grand Met* in a widely circulated article a few months later, Lipton would say: ''Delaware has misled corporate America. . . . It lured companies in with a promise that the business-judgment rule would govern corporate law. It's obvious that the state has reneged.''[105] He even suggested that the Court of Chancery was

[102] *See Blasius*, 564 A.2d at 663 (''It may be that the Blasius restructuring proposal was or is unrealistic and would lead to injury to the corporation and its shareholders if pursued . . . [but a] majority of the shareholders, who were not dominated in any respect, could view the matter differently than did the board. If they do, or did, they are entitled to employ the mechanisms provided by the corporation law and the Atlas certificate of incorporation to advance that view.''); *id.* (a board could buy time and spend corporate funds to tell its story, but once it had that chance, stockholders had to be allowed to decide for themselves whether to elect a new board).

[103] Martin Lipton, *To Our Clients: The* Interco *Case* (Nov. 3, 1988) (''The *Interco* case and the failure of Delaware to enact an effective takeover statute, raise a very serious question as to Delaware incorporation. New Jersey, Ohio and Pennsylvania, among others, are far more desirable states for incorporation than Delaware in this takeover era. Perhaps it is time to migrate out of Delaware.'').

[104] Grand Metro. Pub. Ltd. Co. v. Pillsbury Co., 558 A.2d 1049, 1059–60 (Del. Ch. 1988).

[105] William Meyers, *Showdown in Delaware: The Battle to Shape Takeover Law*, Institutional Investor, Feb. 1989, at 64, 75.

endangering the economic health of the nation: ''You've got a bunch of judges down in Wilmington who are threatening our future, who are depressing the standard of living for the U.S. public. I'm sure Judge Allen doesn't recognize this.''[106]

The article in which those quotes appeared was entitled ''Showdown in Delaware: The Battle to Shape Takeover Law'' and suggested that there was a stark struggle between a Court of Chancery committed to stockholder choice and a Supreme Court committed to the business judgment rule. The intellectual leaders of the two courts, Chancellor Allen and Supreme Court Justice Andrew G.T. Moore II, were portrayed on the cover eyeing each other suspiciously over their shoulders. The article still makes good reading.

But the jurisprudential dispute was on much narrower turf than the article suggested. Both courts, and both their intellectual leaders, had issued rulings strongly protective of stockholders and constraining director discretion.[107] But it was equally true that both courts were also striving conscientiously to work within the traditional framework of Delaware law, and to be as consistent as possible with the principles animating the business judgment rule.[108] The difficult question on which the two courts might part was narrow, but important: if directors believed in good faith after due investigation that a non-coercive tender offer would not be more valuable to stockholders than the benefits the stockholders would receive if the corporation implemented a restructuring of its own or remained independent, could they block the tender offer by just saying no? In other words, if the only threat the directors were addressing was that the stockholders might ignore their advice and take the money, was it reasonable fiduciary behavior under *Unocal* to keep the pill in place? What did *Moran*'s promise of *Unocal* review of a board's deployment of a pill mean if a board could indefinitely block a bid because it believed the stockholders would be unwise to sell?

VII. The Overlooked TW Services *Decision: Chancellor Allen Continues to Outline Carefully the Domains of Director Discretion and Stockholder Choice over Takeover Bids*

In two important decisions following *Interco* and the controversy it generated, Chancellor Allen continued to delineate carefully the line

[106] *Id.* at 77.

[107] Pro-stockholder rulings of the Supreme Court included the controversial *Van Gorkom* decision, *Revlon*, and *Macmillan*.

[108] Good examples of Chancery decisions giving strong deference to board discretion in the M & A context are Chancellor Allen's decisions in *In re* J.P. Stevens & Co., Inc. Shareholders Litigation, 542 A.2d 770 (Del. Ch. 1988) and *In re* Fort Howard Corp. Shareholders Litigation, 1988 WL 83147 (Del. Ch. 1988).

where the legitimate authority of directors ended and the right of stockholders to exercise choice about whether to sell their stock began. The first of these decisions is often overlooked. That was the case of *TW Services, Inc. v. SWT Acquisition Corp.*[109]

TW Services was another pill case, or so it seemed to the plaintiff bidder. But instead of making an unconditional tender offer not dependent on action by the TW Services' board, the bidder, SWT, had conditioned its tender offer on the negotiation of a definitive merger agreement with TW Services. The all cash, all shares offer was attractive to TW Services' stockholders, almost 86% of whom tendered into the offer.

In further contrast to the behavior at issue in *Interco* and many other prior takeover decisions, the TW Services board did not react to the bid by coming up with its own plan to restructure the company. Rather, the board stuck by its existing strategy. It just wanted to say no and get on with its business.

Chancellor Allen was careful to say that *Interco* had not addressed this particular scenario, stating:

> In few instances has this court issued an order requiring a board of directors to redeem a defensive stock rights plan. In those instances, the board itself had elected to pursue either an outright sale of the company and had completed an auction process, or had elected to pursue a defensive restructuring that in form and effect was (so far as the corporation itself was concerned) a close approximation of and an alternative to a pending all cash tender offer for all shares. In those instances, it was thought that the central purpose of a pill—to give a board time to negotiate on shareholders' behalf or to consider alternatives to a tender offer or street sweep that threatened to coerce or otherwise injure shareholders—had been fully served. *Those cases did not involve circumstances in which a board had in good faith (which appears to exist here) elected to continue managing the enterprise in a long term mode and not to actively consider an extraordinary transaction of any type. Thus, I must disagree that the issue posed by this case at this juncture is the same issue as was presented in those cases*. Rather, I accept the TW directors' view that, at this stage of this matter, the pertinent question is whether they have breached a duty owed to the corporation and its shareholders in concluding that they are not required, under the present circumstances, to consider whether or not to place the corporation in a current share value maximizing mode.[110]

[109] 1989 WL 20290 (Del. Ch. 1989).

[110] *Id.* at *9 (emphasis added)(citations omitted).

But the conditionality of SWT's offer on a merger agreement made a crucial difference to Chancellor Allen and permitted him to avoid addressing whether a board could stand behind a pill to remain independent and pursue its current business plan. Because the offer required, in Chancellor Allen's view, the TW Services board to enter into a merger agreement, the offer implicated express managerial authority entrusted to the board by § 251 of the DGCL. As a result, he found that the business judgment rule, and not even the *Unocal* standard, governed the board's decision that a merger was not in the stockholders' best interests. Because that decision seemed to have been made with care and loyalty, Chancellor Allen deferred to it.

In so ruling, Chancellor Allen relied heavily on the fact that the DGCL specifically gave the board a role to play in approving mergers and none in addressing tender offers, stating:

> [T]his case involves one in considering an anomaly. Public tender offers are . . . change in control transactions that are functionally similar to merger transactions with respect to the critical question of control over the corporate enterprise. Yet, under the corporation law, a board of directors which is given the critical role of initiating and recommending a merger to the shareholders (*see* 8 *Del. C.* § 251) traditionally has been accorded no statutory role whatsoever with respect to a public tender offer for even a controlling number of shares. *This distinctive treatment of board power with respect to mergers and tender offers is not satisfactorily explained by the observation that the corporation law statutes were basically designed in a period when large scale public tender offers were rarities; our statutes are too constantly and carefully massaged for such an explanation to account for much of the story. More likely, one would suppose, is the conceptual notion that tender offers essentially represent the sale of shareholders' separate property and such sales-even when aggregated into a single change in control transaction require no ''corporate'' action and do not involve distinctively ''corporate'' interests.*[111]

Chancellor Allen then acknowledged that the poison pill had emerged to close the ''gap'' resulting from the DGCL's failure to address tender offers, but did so in a manner that made clear that managerial self-help was no equivalent, in legitimacy terms, for a statute expressly giving them the defensive authority to block tender offers:

> The so-called ''poison pill'' can, of course, be seen as an attempt to address the flaw (as some would see it) in the corporation law that gives a board of directors a critical role in mergers (and other extraordinary transactions) but gives it no role with respect to

[111] *Id.* (emphasis added)(footnotes omitted).

> public tender offers—a form of extraordinary transaction that threatens equivalent impacts upon the corporation and all of its constituencies including existing shareholders. Thus, with the development of that innovation, *boards of directors began taking upon themselves, unilaterally in practically all instances,* the power to reject a public tender offer (or more correctly, to preclude its completion as a practical matter) by adopting the poison pill stock rights plan.[112]

SWT, the bidder, however, gave Chancellor Allen a chance to sidestep the pill issue. Because SWT had ''implicated not simply the *self-conferred power* arising from the stock Rights Plan, but the board's Section 251 power,'' the board was within its business judgment in refusing to budge and heightened scrutiny was inappropriate.[113] Using this formal reasoning based on the board's legal authority—which was in sharp tension with *Blasius* itself in this respect—Chancellor Allen therefore dodged the just say no issue, leaving it for a pure pill case in which the only issue was whether a board could use the ''self-conferred'' power of the pill to block an unconditional tender offer not subject to any statutory requirement for board involvement.[114]

Chancellor Allen did make one thing clear. If a bidder wanted to deal directly with stockholders, it should do so unconditionally. What it could not do was get a Delaware court to order a board to enter into a merger agreement against its own judgment, even if 86% of the stockholders wanted the directors to do so. Taken together, *Blasius*, *Interco*, and *TW Services* therefore began to shape a corporate law that gave respect to both stockholders and directors within their own domains of choice and authority. Courts were not to second-guess good faith conduct within those domains, but were to ensure that neither stockholders nor directors got out of their lane and usurped improperly authority belonging to the other.

VIII. The Short Life of Interco *Underscores the Purpose and Enduring Utility of* Blasius

The end to Chancellor Allen's journey to map out the respective domains of director authority and stockholder choice in the M & A context came with a second case he decided after *Interco*, or rather when the Supreme Court issued its decision reviewing his ruling below.

That case was, of course, *Paramount Communications, Inc. v. Time Inc.*,[115] or *Time–Warner* as it is commonly known. The story line is

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[112] *Id.* at *10 (footnote omitted) (emphasis added).

[113] *Id.* at *11 (emphasis added).

[114] *Id.*

[115] 1989 WL 79880 (Del. Ch. 1989), *aff'd*, 571 A.2d 1140 (Del. 1989).

familiar. Time Inc. was an establishment company with a blue-chip board. Its management, with full board involvement, had studied ways to improve the corporation's competitiveness. After great study and arms-length negotiations, Time entered into a stock-for-stock merger agreement with Warner, calling for Time to pay Warner stockholders 0.465 of a Time share for each Warner share, a premium of 12%. After the merger, Warner stockholders would own 62% of the combined entity, which was to be governed by a 24-person board drawn equally from each corporation's board of directors. A special mechanism was set up to protect Time's traditional structure, whereby the editor-in-chief of certain magazines reported only to a special committee of the outside directors of the board. A complicated managerial succession plan was negotiated, with the Time and Warner CEOs to serve as co-CEOs of the combined entity for five years and an agreement that the Time CEO would become sole CEO after that.

Warner had a movie studio, cable television assets, and a music division, all of which presented the opportunity for a combined Time–Warner to be able to produce and deliver to consumers a wide variety of content in a variety of formats. Certainly, the stock market thought the deal made sense, as the value of each corporation's stock rose considerably upon the announcement of the merger to a high in the $125 range for Time shares.

Although the DGCL did not require a vote of the Time stockholders, as originally crafted, the Time stockholders did have to vote on the merger. Because Time was issuing more than 20% of its outstanding shares to acquire Warner, the New York Stock Exchange Rules required that the Time stockholders approve the merger, and thus the original merger agreement called for them to vote.

Indeed, it was only when Time put out a proxy statement to its stockholders in advance of a June 23 meeting to approve the merger that Paramount entered the game. Wanting to act after Time's board had asked its stockholders to vote on the merger, Paramount delayed making an offer until that time, and then launched a tender offer at $175 per share, causing Time shares to rise by an astonishing $44 on one day.

Undeterred, the Time board ploughed ahead. Although its financial advisor estimated that the new Time–Warner stock would trade for around $150 after the merger, the advisor also provided out-year trading estimates, culminating in a trading range of $208–402, which Chancellor Allen referred to as a ''range that a Texan might feel at home on.''[116]

Recognizing that it could not obtain its stockholders' approval of the merger, the Time board renegotiated the merger agreement. Instead of a

[116] 1989 WL 79880, at *13 (Del. Ch.1989).

stock for stock merger, Time agreed to pay Warner stockholders $70 per share, or a hefty 56% premium over the pre-announcement price of their shares. As a result of this change, the combined company would have large debt loads and no reportable earnings for several years, which eliminated some of the major benefits the companies touted when they pitched the merger originally. More critically to the outcome of the drama, however, was the fact that a cash transaction did not implicate any requirement for Time stockholder approval under the NYSE rules. So long as the Warner stockholders liked the $70 offer, the merger could be consummated. As under the original plan, Time and Warner would be put together. But under the new route, the Time stockholders would get no say.

Paramount reacted to the revised merger agreement by upping its bid to $200. Time did not budge and never expressed any interest in talking to Paramount, much less in going to Warner and asking to get out of its deal.

The case then came to court with Paramount seeking an injunction against the consummation of the Time tender offer that was to be the first step to closing the merger. Because Paramount's own offer was conditioned on certain regulatory approvals that had not yet been received (and which Time had acted to delay and thwart), Paramount did not seek to have Time ''dismantle its 'poison pill' takeover defense.''[117]

Chancellor Allen was thus faced with a stark situation. Time's board wished to go forward with a revised merger agreement that Time stockholders, if given their druthers, would have tossed aside in a New York minute in favor of the chance to get $200 from Paramount. But the Time board had not cooked up the combination as a reflex reaction to the possibility of a takeover bid; it had studied the combination for years and come to a reasoned conclusion that a combination of Time and Warner would be a formidable generator of profits.

Chancellor Allen was not at all blind to the possibilities for abuse the situation presented. But he was also dealing with a paper record and a Time board comprised largely of distinguished outside directors with no financial interest to favor a deal with Warner over one with Paramount. Thus, the Chancellor acknowledged the legitimate room for skepticism about the Time board's motivations, but ultimately rejected them as a basis for making a ruling. For example, he devoted considerable attention to the possibility that the Time board's motivation in preserving so-called ''Time culture'' through the guarantee that Time's managers would play the lead role in the combined entity had nothing to do with protecting stockholders, and everything to do with protecting other social values that Time supposedly embodied. Thus, he drolly

[117] *Id.* at *1.

noted that ''[o]ne is entitled to be suspicious, therefore, that some other motivation than protecting the journalistic integrity of *Time* and *People* magazines may be at work in the insistence on assuring the integrity of the journalism for financial reasons.''[118]

But he then dealt with the core social issue directly and seriously:

> There may be at work here a force more subtle than a desire to maintain a title or office in order to assure continued salary or perquisites. Many people commit a huge portion of their lives to a single large-scale business organization. They derive their identity in part from that organization and feel that they contribute to the identity of the firm. The mission of the firm is not seen by those involved with it as wholly economic, nor the continued existence of its distinctive identity as a matter of indifference.[119]

Nonetheless, he found that there was an insufficient record to conclude that these social considerations had caused the Time board to subordinate their duty to manage the corporation in the manner that, in the long term, would benefit stockholders most, stating:

> Thus, while the record suggests that the ''Time culture'' importantly includes directors' concerns for the larger role of the enterprise in society, there is insufficient basis to suppose at this juncture that such concerns have caused the directors to sacrifice or ignore their duty to seek to maximize in the long run financial returns to the corporation and its stockholders.[120]

Famously, Chancellor Allen then went on to hold that because the Time–Warner merger agreement did not result in a change in control of Time from its diverse stockholder base to a controlling stockholder, *Revlon* was inapplicable to the Time board's conduct. So long as the board believed in good faith that the Time–Warner merger agreement would, in the long run, produce greater benefits for stockholders than the Paramount $200 bid, the board was within its discretion to consummate the merger:

> It may be that in a well-developed stock market, there is no discount for long-term profit maximizing behavior except that reflected in the discount for the time value of money. It may be the case that when the market valued the stock of Time at about $125 per share following the announcement of the merger, an observer blessed with perfect foresight would have concurred in that value now of the future stream of all returns foreseen into eternity. Perhaps wise

[118] *Id.* at *6. (emphasis added)

[119] *Id.* at *7.

[120] *Id.*

> social policy and sound business decisions ought to be premised upon the assumptions that underlie that view. But just as the Constitution does not enshrine Mr. Herbert Spencer's social statics, neither does the common law of directors' duties elevate the theory of a single, efficient capital market to the dignity of a sacred text.
>
> Directors may operate on the theory that the stock market valuation is ''wrong'' in some sense, without breaching faith with shareholders. No one, after all, has access to more information concerning the corporation's present and future condition. It is far from irrational and certainly not suspect for directors to believe that a likely immediate market valuation of the Time–Warner merger will undervalue the stock.[121]

Although he acknowledged that the *Unocal* standard was applicable because the Time board had adjusted the merger in response to the Paramount bid, Chancellor Allen found that the board met its burden under that standard to act reasonably. In the first instance, he held that the Time board had a reasonable basis to conclude that the Paramount offer, which was conditioned on the termination of the merger agreement with Warner, was a threat: ''In my opinion, where the board has not elected explicitly or implicitly to assume the special burdens recognized by *Revlon,* but continues to manage the corporation for long-term profit pursuant to a preexisting business plan that itself is not primarily a control device or scheme, the corporation has a legally cognizable interest in achieving that plan.''[122]

He then found that the reconfiguration of the merger to eliminate the stockholder vote and permit its consummation by board action only was a proportionate step, because it simply permitted the board to carry out its pre-existing strategy and because that '' 'defensive' step [did] not legally preclude the successful prosecution of a hostile tender offer. And while effectuation of the Warner merger may practically impact the likelihood of a successful takeover of the merged company, it is not established in this record that that is foreclosed as a practical matter.''[123]

Recognizing that his decision would be controversial to many scholars and upsetting to Time stockholders, Chancellor Allen ended with an intellectual justification for the result:

> Reasonable persons can and do disagree as to whether it is the better course from the shareholders' point of view collectively to cash out their stake in the company now at this (or a higher) premium cash price. However, there is no persuasive evidence that

[121] *Id.* at *19.

[122] *Id.* at *29.

[123] *Id.*

> the board of Time has a corrupt or venal motivation in electing to continue with its long-term plan even in the face of the cost that that course will no doubt entail for the company's shareholders in the short run. In doing so, it is exercising perfectly conventional powers to cause the corporation to buy assets for use in its business. Because of the timing involved, the board has no need here to rely upon a self-created power designed to assure a veto on all changes in control.
>
> The value of a shareholder's investment, over time, rises or falls chiefly because of the skill, judgment and perhaps luck-for it is present in all human affairs-of the management and directors of the enterprise. When they exercise sound or brilliant judgment, shareholders are likely to profit; when they fail to do so, share values likely will fail to appreciate. In either event, the financial vitality of the corporation and the value of the company's shares is in the hands of the directors and managers of the firm. The corporation law does not operate on the theory that directors, in exercising their powers to manage the firm, are obligated to follow the wishes of a majority of shares. In fact, directors, not shareholders, are charged with the duty to manage the firm.[124]

But how had Chancellor Allen arrived at that place: by writing around his decisions, not only in *Interco*, but in *Blasius*. As to *Interco*, Chancellor Allen made plain that he distinguished between a situation when a board was simply exercising a bona fide business judgment utilizing clear statutory powers set forth in the DGCL, such as the power to buy another corporation for cash in a merger, and when a board was ''rely[ing] upon a self-created power designed to assure a veto on all changes in control,'' noting that:

> [I]n my view, a decision not to redeem a poison pill, which by definition is a control mechanism and not a device with independent business purposes, may present distinctive considerations than those presented in this case.[125]

Thus, as in *SWT* and *Interco*, Chancellor Allen voiced some resistance to the broad reading to ''management'' given by the Supreme Court in *Unocal* and *Moran*, suggesting that the legitimacy and authority of a board to use a pill was far less than to enter into a merger, that the use of a ''self-created power'' to prevent stockholders from selling their stock to a tender offeror by drawing on statutory authority never adopted with that purpose in mind was more suspect and deserving of far greater scrutiny.

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[124] *Id.* at *30 (footnote omitted).

[125] *Id.* at *30 n.22.

But even if the Time board was drawing on its express § 251 power to enter into a merger agreement, how did Chancellor Allen permit the Time board to withdraw from the stockholders the chance to vote on this transformational merger? Did not the Time board act precisely so as to thwart a majority of the Time stockholders from rejecting the merger? Wasn't this precisely what *Blasius* was designed to prevent?

Certainly, the plaintiffs in the case thought so and argued that *Blasius* was right on point. The Chancellor employed formalism in rejecting that argument, stating:

> Plaintiffs' reliance upon *Blasius* is misplaced here. There are critical distinctions between the facts of that case and this one. There, the shareholders were in the process of exercising statutorily conferred rights to elect directors through the consent process. *See* 8 *Del. C.* § 228. In contrast, Delaware law created no right in these circumstances to vote upon the original Warner merger. Indeed, a merger transaction requires board determination approving an agreement of merger. *See* 8 *Del. C.* § 251(b). I am aware of no principle, statute or rule of corporation law that would hold that once a board approves an agreement of merger, it loses power to reconsider that action prior to a shareholder vote. Equally fundamentally, Delaware law creates no power in shareholders to authorize a merger without the prior affirmative action of the board of directors. Thus, a board resolution rescinding approval of an agreement of merger and removing the matter from the agenda of an annual meeting is altogether different from a resolution designed to interfere with the statutory shareholder power to act through consent.[126]

Notably, this reasoning, had it been employed in *Blasius* itself, would have changed the outcome if *Blasius* rested on its broadest language. Just as was the case in *Time–Warner*, the Atlas stockholders had no statutory right to have the chance to fill the seats occupied by Winters and Devaney. Consistent with the statute, the Atlas board had acted to fill those seats using its legal authority. The Atlas board did not take away the statutory rights of its stockholders to act by written consent, it simply used its own statutory and contractual authority in a way that limited the number of directors that could be removed by written consent. But in *Time–Warner*, the board was permitted by Chancellor Allen to fix the wounded bird (in this case, the merger itself) by denying the stockholders the chance to vote.

Why the distinction?

The Supreme Court's decision in *Time–Warner* suggests two reasons. Although that decision affirmed Chancellor Allen's denial of an

[126] *Id.* at *26 (footnote omitted).

injunction, it was affirming of him only in result.[127] Rather than engage in the precise parsing of the record and law that exemplified the decision below, the Supreme Court's ruling was clearly designed to send a message to both corporate America and the Court of Chancery about the scope of board authority to reject a takeover offer and continue on its previous path. Even though *Time–Warner* was not a pill case, the Supreme Court used dictum to lash out at *Interco*, stating:

> *Unocal* involved a two-tier, highly coercive tender offer. In such a case, the threat is obvious: shareholders may be compelled to tender to avoid being treated adversely in the second stage of the transaction. . . . In subsequent cases, the Court of Chancery has suggested that an all-cash, all-shares offer, falling within a range of values that a shareholder might reasonably prefer, cannot constitute a legally recognized ''threat'' to shareholder interests sufficient to withstand a *Unocal* analysis. *AC Acquisitions Corp. v. Anderson, Clayton & Co.,* Del. Ch., 519 A.2d 103 (1986); *see Grand Metropolitan, PLC v. Pillsbury Co.,* Del. Ch., 558 A.2d 1049 (1988); *City Capital Associates v. Interco, Inc.*, Del. Ch., 551 A.2d 787 (1988). In those cases, the Court of Chancery determined that whatever threat existed related only to the shareholders and only to price and not to the corporation.
>
> From those decisions by our Court of Chancery, Paramount and the individual plaintiffs extrapolate a rule of law that an all-cash, all-shares offer with values reasonably in the range of acceptable price cannot pose any objective threat to a corporation or its shareholders. Thus, Paramount would have us hold that only if the value of Paramount's offer were determined to be clearly inferior to the value created by management's plan to merge with Warner could the offer be viewed—objectively—as a threat.
>
> Implicit in the plaintiffs' argument is the view that a hostile tender offer can pose only two types of threats: the threat of coercion that results from a two-tier offer promising unequal treatment for non-tendering shareholders; and the threat of inadequate value from an all-shares, all-cash offer at a price below what a target board in good faith deems to be the present value of its shares. *See, e.g.*, *Interco*, 551 A.2d at 797. Since Paramount's offer was all-cash, the only conceivable ''threat,'' plaintiffs argue, was inadequate value. We disapprove of such a narrow and rigid construction of *Unocal*. . . .

[127] In several key respects, the affirming decision parted ways from the reasoning of Chancellor Allen; most famously, in affirming his decision that *Revlon* was inapplicable, but for a different reason than he articulated. 571 A.2d at 1150. In its later decision in *QVC*, the Supreme Court re-embraced this aspect of Chancellor Allen's reasoning in *Time–Warner*. *See* Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34 (Del. 1994).

> Plaintiffs' position represents a fundamental misconception of our standard of review under *Unocal* principally because it would involve the court in substituting its judgment as to what is a ''better'' deal for that of a corporation's board of directors. To the extent that the Court of Chancery has recently done so in certain of its opinions, we hereby reject such approach as not in keeping with a proper *Unocal* analysis. *See, e.g.*, *Interco*, 551 A.2d 787, and its progeny; *but see TW Services, Inc. v. SWT Acquisition Corp.*, Del. Ch., C.A. No. 1047, Allen, C. 1989 WL 20290 (March 2, 1989).[128]

Ouch.[129] Not only that, the Supreme Court embraced the very concept of ''substantive coercion'' from the Gilson & Kraakman article that Chancellor Allen had carefully eschewed accepting. Thus, the Court stated that an all shares, all cash offer could be deemed coercive and thus a threat because the stockholders might ''mistakenly accept an underpriced offer because they disbelieve management's representation's of [the target's] intrinsic value.''[130] Even more problematically, the Supreme Court attributed its acceptance of this doctrine to the authors, stating that they recognized that the acceptance of this doctrine ''would help guarantee that the *Unocal* standard bec[ame] an effective intermediate standard of review.''[131]

But, of course, that is not what Gilson and Kraakman said. They actually preferred that a ''just say no'' defense grounded in so-called substantive coercion not be accepted by the courts at all.[132] But they sensed it would be and thus argued that if a just say no defense to an all shares, all cash offer was to be accepted, then the courts had a responsibility to put the directors to the test by making them put on a substantive economic case demonstrating the reasonableness of their

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[128] 571 A.2d at 1152–53 (citations omitted)(footnote omitted).

[129] Elsewhere, I have noted that the description of *Interco* given was inaccurate, particularly the reference to the court having rested its decision in that case on its view of the better deal. *See* Strine, *supra* note 65, at 892 n.59; *see also* Ronald J. Gilson, *The Fine Art of Judging: William T. Allen*, 22 Del. J. Corp. L. 914, 920 (1997) (same). *Interco* expressly avoided any such judgment, and simply held that stockholders were entitled to choose whether to accept a non-coercive tender offer.

[130] 571 A.2d at 1153 n.17.

[131] *Id.*

[132] At several places in the text, the authors reveal their preference that Delaware not sanction preclusive defenses against takeovers, including by citing to a prominent article to that effect by one of the authors. *E.g.*, Gilson & Kraakman, *supra* note 98, at 250 (citing Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 Stan. L. Rev. 819, 841–50 (1981)); *see also* Gilson & Kraakman, *supra* note 98, at 263 (articulating the empirical evidence that suggested that leaving the ultimate decision whether to accept a structurally non-coercive offer to stockholders was the wisest policy).

position on the comparative valuation merits of their stand-alone strategy and the tender offer.[133] That the Supreme Court did not accept this aspect of the professors' reasoning was made emphatically clear when the Court said:

> Paramount argues that, assuming its tender offer posed a threat, Time's response was unreasonable in precluding Time's shareholders from accepting the tender offer or receiving a control premium in the immediately foreseeable future. Once again, the contention stems, we believe, from a fundamental misunderstanding of where the power of corporate governance lies. Delaware law confers the management of the corporate enterprise to the stockholders' duly elected board representatives. 8 *Del. C.* § 141(a). The fiduciary duty to manage a corporate enterprise includes the selection of a time frame for achievement of corporate goals. That duty may not be delegated to the stockholders. 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.[134]

In fact, the Court's iteration of *Unocal* as permitting directors to block a bid and remain independent ''unless there was clearly no basis'' for the board's judgment was exactly the sort of deferential, business judgment rule form of review that Professors Gilson and Kraakman feared *Unocal* would devolve into.

The two-by-four reasoning of *Time–Warner* suggests why Chancellor Allen narrowed the *Blasius* target in his own decision. A savvy, sophisti-

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[133] In fact, Gilson & Kraakman end their article in a way that makes clear how distant the *Time–Warner* reasoning was from their intentions:

> [S]ubstantive coercion is a slippery concept. To note abstractly that management *might* know shareholder interests better than shareholders themselves do cannot be a basis for rubber-stamping management's pro forma claims in the face of market skepticism and the enormous opportunity losses that threaten target shareholders when hostile offers are defeated. Preclusive defensive tactics are gambles made on behalf of target shareholders by presumptively self-interested players. Although shareholders may win or lose in each transaction, they would almost certainly be better off on average if the gamble were never made in the absence of meaningful judicial review. Over the next year, the currents of corporate litigation are likely to bring the Delaware courts to a crossroads. A parade of novel defensive tactics . . . has placed the power to defeat a hostile bid within reach of target managements. If the proportionality test lives up to its promise as a meaningful intermediate standard of review, it can do much to correct the widespread view that Delaware law has taken a definitive turn against hostile acquisitions. By contrast, if the proportionality test follows the rhetorical slide seemingly suggested by some aspects of the analysis in *Unocal* . . . it will become little more than another reminder to business planners to watch what the Delaware courts do and not what they say.

Gilson & Kraakman, *supra* note 98, at 274.

[134] 571 A.2d at 1154 (citation omitted).

cated reader of appellate tea leaves, Allen likely had a sense that *Interco*'s days were numbered. If he employed his new *Blasius* doctrine in *Time–Warner*, he risked having the Supreme Court not only lash out at *Interco*, but cast doubt on *Blasius*. If it did so, that would have invited boards to block both the front (tender offer) and back (electoral) door to changes in control that might be good for stockholders. Thus, this pragmatic concern was one reason.

The more doctrinal reason is suggested by the Supreme Court's embrace of the doctrine of substantive coercion. Chancellor Allen refused to give credence in *Interco* to the notion that a board could use a ''self-created power'' to prevent stockholders from selling into a non-coercive bid simply because the board believed it knew better than the stockholders about what was best for them.[135] But he knew that *Unocal* and *Moran* had already held that directors had substantial authority to block takeover bids, and that the Supreme Court might well acknowledge that directors, during their term of office, could ''just say no'' as long as they had a rational, good faith belief that remaining independent was best for stockholders.

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[135] In an important article reflecting on the long-standing debate regarding the purpose for which the for-profit corporation is to be governed, Chancellor Allen reflected back on the pressures faced by the Delaware courts in the 1980s. He noted there was a conflict between two different views of the corporation: the view that the corporation should be managed to maximize returns to its equity investors (a view he calls the ''property'' conception) and the view that a corporation could be managed to advance the interests of all its constituents, including society's (a view he called the ''entity'' conception). In doing so, he noted that a traditional tool courts had used to avoid deciding between those conceptions—the rationale that managerial action that had the short-term effect of reducing returns would pay off in higher returns to stockholders long-term—

> could not be persuasively be used . . . to justify precluding the shareholders from selling their stock at a large immediate profit on the ground that in the long run that will be good for them. While one might of course say that, many people would find it disturbing to put such a result on the basis that directors know what is better for shareholders than they themselves do. Instead the scope and nature faced seemed to demand a facing up to the conceptual questions: For whom are directors to act? . . .
>
> Courts [in the 1980s] were not anxious to grapple with this question. To resolve the matter seemed plainly to call for the making of policy in an environment that was warmly contested by powerful interests and in which no widely accepted doctrine offered a clear guide.''

William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 Cardozo L. Rev. 261, 275 (1992). Allen admitted to having avoided answering the core question himself in the line of decisions he issued culminating in his *Time–Warner* decision, and to having tried to achieve a consistent approach to addressing takeover battles by parsing out, through the case by case method, the respective domains of board authority and stockholder choice. *Id*. at 275–76, n. 48. He reads the Supreme Court's *Time–Warner* decision as having adopted, ''in effect,'' the entity view by ''seem[ing] to have expressed the view that corporate directors, if they act in pursuit of some vision of the *corporation's* long-term welfare, may take action that precludes shareholders from accepting an immediate high-premium offer for their shares.'' *Id.* at 276 (emphasis added).

What was most critical and central to the *Blasius* ruling was not that a majority of stockholders be given the chance to vote on anything whenever that was possible. During the directors' term of office, they had wide discretion to use their core authority to make business judgments stockholders would not favor. *Blasius* did not convert the corporation into an ongoing New England town meeting.[136] Rather, what was core to *Blasius* was that the judiciary not accept the doctrine of substantive coercion as a justification for director conduct affecting the election process. When the only argument that directors could muster for making it harder or impossible for stockholders to remove them from office and seat a new board was that the incumbents believed it was better for the stockholders that they remain in office, Chancellor Allen wanted there to be virtually zero judicial tolerance. Precisely because directors were likely to be granted capacious authority to lock the front door to a change in control, they could not be allowed to prevent the stockholders from deciding that a new set of directors should exercise that authority. That was not ''managing the company,'' that was acting like a Latin American ruler in the latter part of the last century, declaring an end to democracy in order to protect the people from the dangers that would arise if the people erroneously ousted him at the upcoming election.

By categorizing a ''substantive coercion'' defense in the director election context as presumptively illegitimate and unauthorized action subject to severe scrutiny, *Blasius* helped maintain the credibility of Delaware corporation law at a crucial time in its history.[137] Although many would argue that Delaware would have been better off embracing *Interco*, Delaware's vigilant policing of the election process, when combined with the very real pressure *Unocal* continued to create for vesting decision-making in the hands of independent directors and the potency of *Revlon* when it was applicable, ensured that the American market for corporate control remained strong and vibrant.[138] After all, you can just

[136] *See TW Servs.*, 1989 WL 20290, at *8 n.14 (''‘Shareholder democracy' is an appealing phrase, and the notion of shareholders as the ultimate voting constituency of the board has obvious pertinence, but that phrase would not constitute the only element in a well articulated model. While corporate democracy is a pertinent concept, a corporation is not a New England town meeting; directors, not shareholders, have responsibilities to manage the business and affairs of the corporation, subject however to a fiduciary obligation.'').

[137] The subsequent history of *Blasius* is complex and has been considered elsewhere. *See, e.g.*, Allen, Jacobs & Strine, *supra* note 54, at 1311–16; Chesapeake Corp. v. Shore, 771 A.2d 293, 319–20 (Del. Ch. 2000); Mercier v. Inter–Tel (Delaware), Inc., 929 A.2d 786, 806 (Del. Ch. 2007). What is important for present purposes is that *Blasius*'s call for strong judicial policing of director conduct impairing the ability of stockholders to elect a new board has been heeded.

[138] As it turns out, Marty Lipton turned from a critic to an enthusiastic fan of Chancellor Allen's jurisprudence, and wrote a warm tribute to the Chancellor's tenure on

say no all you want, but it doesn't matter anymore if you're no longer a director.

Chancery, in which he acknowledged *Blasius*'s importance in keeping the market for corporate control open after the decision in *Time–Warner*. *See* Martin Lipton & Theodore N. Mirvis, *Chancellor Allen and the Director*, 22 Del. J. Corp. L. 927, 934–35 (1997).

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