

The *Delaware Journal of Corporate Law*  
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*presents the*

## 33rd Annual Francis G. Pileggi Distinguished Lecture in Law

**Is Delaware Retreating?**

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**Friday, October 20, 2017**

**8:00 a.m. Breakfast; 8:45 a.m. Lecture**

Hotel DuPont, du Barry Room  
11th and Market Streets  
Wilmington, Delaware 19801

*Encore presentation 11 a.m.*  
*Widener University Delaware Law School*

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# Delaware's Retreat: Exploring Developing Fissures and Tectonic Shifts in Delaware Corporate Law

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## Key Corporate Law Cases That Changed Judicial Review of Board Decisions

- We focus on four critical decisions from the 1980's that changed the scope of judicial review by Delaware courts:
- Revlon – sale of control
- Weinberger – minority shareholder squeezeouts
- Unocal – defensive tactics
- Blasius – shareholder voting

## How Have Those Cases Evolved Over Time?

- Within the space covered by each doctrine, Delaware has reduced judicial scrutiny of board actions
- Instead, Delaware law has shifted toward giving more deference to independent boards' decisions (Unocal), more use of process-oriented devices and greater deference to after the fact shareholder approval of board actions (Revlon and Weinberger), and greater reluctance to intervene in manager-shareholder arguments over the boundaries of their power (Blasius)

## Why Have These Changes Occurred?

- We argue that there have been significant corporate governance shifts since the 1980's that have led to these shifts
- These changes include:
  - Growing use of independent directors – they are invariably a majority of the board of directors now
  - Increased concentration of institutional shareholdings and the rise of ISS – large investors are more assertive about getting what they want
  - Hedge fund activism – since early 2000s, activist hedge funds have been aggressively targeting underperforming companies and frequently have succeeded in forcing changes at them
  - Recent explosion in deal litigation – up to 96% of larger deals attract shareholder litigation in 2013

## Are These Changes a Good Thing?

- Some commentators have applauded them, claiming that private enforcement efforts have run amok and arguing independent directors, shareholder voting and procedural protections provide ample protection
- Other commentators have criticized them, pointing out that shareholder monitoring of corporate management will be weakened, increasing the potential for an increased incidence of corporate misconduct

## Revlon – The Beginning

- Perelman makes hostile bid, Revlon deploys defenses, but Perelman persists in his efforts to takeover the company
- Board determines to sell the company to Forstmann Little; ultimately offers them substantial preferences to make a second bid
- Directors' role changed to being "auctioneers" once they determined to sell the company – must seek best deal
- Court engages in close judicial scrutiny of preferential treatment of one bidder over another in a sale of the company
- Two bidder situation with strong scent of self dealing in the case

## Paramount/QVC – Clarifying Revlon

- Friendly deal between Paramount and Viacom that has strong deal protections is disrupted by QVC's announcement of a competing bid
- Viacom and QVC get into a bidding contest but presence of deal protections interferes with P board's consideration of QVC offer
- Court concludes that the initial friendly deal constituted a change of control transaction triggering Revlon because it would create a controlling shareholder in the newly merged entity
- Court strikes down deal protections as breach of director duties
- In a two bidder setting, the directors' actions in preferring one bidder over another are carefully scrutinized against the best offer criterion

## Lyondell and One Bidder Cases

- Lyondell involves a single bidder that makes a strong bid to buy the company and a board that accepts it without doing much negotiating in a short period of time
- Court says Revlon did not create any new director fiduciary duties – just duty of care and duty of loyalty
- Duty of care claims are difficult in one bidder cases because 102(b)(7) eliminates post-closing money damage claims – no injunction is likely to be possible in one bidder cases
- Lyondell makes duty of loyalty claims problematic too by saying that independent directors must “utterly fail to attempt to obtain the best price” to be found to have breached the duty of loyalty



## Corwin— Revlon's Closing Act?

- A one bidder, stock for stock merger deal that the Delaware Supreme Court treated as if it had triggered Revlon
- Court holds that in an arm's length M&A transaction involving a sale of control under Revlon a fully informed, non-coerced, disinterested shareholder vote approving the deal invokes the business judgment standard of review
- Court effectively overrules earlier precedent requiring separate votes for this purpose-- one vote approving the merger and a second vote ratifying the directors' actions in conducting the transaction

## Corwin's Implications and Justifications

- On the positive side, in single bidder cases, using shareholder voting to replace judicial review will lead to less litigation and its associated costs
- But if shareholder approval absolves the board from any liability under Revlon, will we see boards abandoning auctions and market checks as unnecessary parts of their sale process?
- More importantly, bundling the merger approval vote with the merger ratification vote into a single vote confronts shareholders with a distorted choice – if they vote in favor of a deal where there is clear board impropriety, what does that vote mean?
- Unbundling the vote on the two items would allow shareholders to send a clear message about both things

## Weinberger and Entire Fairness Review

- Control shareholder (CS) squeezeout where two interlocking directors did a valuation of target firm using target private information and gave it to the CS acquirer's board but not the target's board
- Target board did almost no negotiating then concluded the deal on a hasty basis without any pressing reason
- Court applies entire fairness standard and finds CS breached its duties to the minority shareholders; remands for damage determination
- In footnote, Court exhorts future deals to use special committee to shift burden of proof in entire fairness test onto plaintiff
- Court also notes that MOM vote would have similar effect

## Kahn v. Lynch: The Rise of the Special Committee

- Delaware Supreme Court clarifies that a special committee in a CS squeezeout must have "real bargaining power" for a shift in the burden of proof onto the plaintiff in entire fairness analysis
- The CS negotiated with the Special Committee but when an impasse was reached, the CS threatened to move forward with a tender offer at a lower price, leading the Court to deny the burden shift
- Court states that entire fairness analysis remains the proper standard for judicial review even if Special Committee or MOM vote is used because existence of control shareholder is inherently coercive
- Does not decide the effect of Special Committee and MOM vote

## M&F Worldwide – Using Procedural Protections to Eliminate Entire Fairness Analysis

- CS makes a proposal to take a company private contingent on approval by an “empowered” independent special committee and an uncoerced, fully informed, MOM vote
- Court concludes that the combination of those two procedural devices was equivalent to approval of a fully independent board and an uncoerced shareholder vote in an arm’s length transaction, and therefore applies business judgment review of the deal
- Court rejects plaintiffs’ arguments that special committee is a weak negotiator because it is comprised of directors selected by the CS and that minority vote suffers from inherent coercion from presence of CS

## Effects of M&F Worldwide (and Corwin)

- Move to substitute procedural protections and shareholder vote for judicial oversight will undoubtedly reduce risk of litigation
- Making it harder for shareholders to successfully challenge deals in Delaware has the predictable effect that deal litigation will migrate to other venues, such as federal court
- Within Delaware, also predictable that shareholders will seek to pursue alternative remedies, which may account partly for the upsurge in appraisal cases
- Further, CS incentives to pay high price for minority interests are reduced if monitoring role of litigation is weakened



## Unocal - Heightened Judicial Review of Defensive Tactics

- Prior to 1985, Delaware courts generally applied business judgment review for target defensive actions
- T Boone Pickens makes a two tiered, front end loaded, coercive tender offer to buy Unocal Corporation
- Board determines that the offer is coercive and inadequate and adopts a discriminatory self tender offer as a defensive tactic
- Delaware Supreme Court holds that due to the “omnipresent specter” of board entrenchment when deploying defensive measures it will apply enhanced judicial scrutiny to Unocal board action and adopts new two part test for these situations

## Interco— The Path Not Taken

- Three years later, Rales brothers make an all cash, all shares, hostile bid for Interco, seeking to bust up the company and sell the parts
- Target board responds by adopting a new poison pill and announcing a massive restructuring of the company that would have much the same effect as the Rales’ bust up proposal
- Chancellor Allen determines that the offer is not coercive and that the poison pill could be kept in place while management sought to negotiate a higher price, or propose an alternative transaction, but that after that period had elapsed, the poison pill should be redeemed to allow shareholders to choose between the tender offer and the management restructuring option













