RETRACING DELAWARE'S CORPORATE ROOTS THROUGH RECENT DECISIONS: CORPORATE FOUNDATIONS REMAIN STABLE WHILE JUDICIAL STANDARDS OF REVIEW CONTINUE TO EVOLVE

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Delaware's renowned corporation law rests upon a director-centric premise, reflected in Section 141 of the Delaware General Corporation Law ("DGCL"), that the business and affairs of corporations are to be managed by boards of directors. In carrying out this mandate, directors owe fiduciary duties requiring that they act in an informed manner (*i.e.*, the duty of care) and only in the best interests of the corporation and all of its shareholders (*i.e.*, the duty of loyalty). Consistent with the legislative judgment placing directors at the helm of the corporate enterprise, and mindful of the necessary risk-taking inherent in that role, the Delaware courts afford unconflicted, informed, and properly motivated directors wide latitude in carrying out their duties. That deference is reflected in the venerable business judgment rule, under which courts will not second-guess the decisions of independent and disinterested directors acting in good faith and following an appropriate decision-making process.

This Article explores seven significant decisions of the Supreme Court of Delaware and the Delaware Court of Chancery over the last eighteen months addressing various director challenges and the appropriate standards of judicial review for assessing the propriety of the contested conduct. Part I of this Article addresses *In re Citigroup Shareholder Derivative Litigation*,[1] which involved director business risk oversight allegations and emphasized the continued viability of the business judgment rule in this setting. Part II of this Article discusses *Selectica, Inc. v. Versata, Inc.*,[2] including the Court's application of enhanced scrutiny to a modern shareholder rights plan with a 4.99% threshold and the deference afforded directors who are well informed and advised by sophisticated experts. Part III of this Article examines *Lyondell Chemical Co. v. Ryan*,[3] which revisited the *Revlon* doctrine and raised the bar for plaintiffs seeking to establish that unconflicted directors failed to maximize shareholder value in the sale of corporate control context. Part IV of this Article evaluates *In re John Q. Hammons Hotels Inc. Shareholder Litigation*[4] and the applicability of entire fairness review to transactions involving controlling shareholders not standing on both sides of the underlying transaction, as well as the effect that special committees and majority-of-the-minority conditions should have on the governing standards for assessing such transactions. Part V of this Article highlights a number of related issues addressed in *In re CNX Gas Corporation Shareholders Litigation*,[5] which departed from the traditional deferential review accorded two-step "*Siliconix*" freeze-out transactions

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1. 964 A.2d 106 (Del. Ch. 2009).

2. 2010 WL 703062 (Del. Ch. Feb. 26, 2010).

3. 970 A.2d 235 (Del. 2009).

4. 2009 WL 3165613 (Del. Ch. Oct. 2, 2009).

5. 2010 WL 2291842 (Del. Ch. May 25, 2010).

by a controlling shareholder in favor of a "uniform standard" similar to the one employed in *Hammons*. Part VI of this Article reviews *Berger v. Pubco Corporation*[6] and the appropriate parameters of the quasi-appraisal remedy arising from a controlling shareholder's breach of its disclosure obligations in connection with a short-form merger. Part VII of this Article recounts the emphasis of the Court in *Maric Capital Master Fund Ltd. v. PLATO Learning, Inc.*[7] on the importance of full disclosure in conventional long-form mergers and the risk to corporate transactions absent such disclosure. This Article concludes in Part VIII that, together, these decisions reaffirm the tenets underlying Delaware's director primacy model and the policy judgments upon which the business judgment rule rests.

I. *IN RE CITIGROUP INC. SHAREHOLDER DERIVATIVE LITIGATION*

Director oversight liability has been an established cause of action in Delaware's corporate jurisprudence since the Court of Chancery's holding, in *In re Caremark International Derivative Litigation*,[8] that the directors' duty to remain "reasonably informed" necessarily requires that they ensure that "information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board … to reach informed judgments concerning both the corporation's compliance with law and its business performance."[9] Unlike traditional *Caremark* oversight claims that the directors failed to properly monitor the corporation's regulatory or compliance risk, *In re Citigroup Shareholder Derivative Litigation*[10] presented the Court of Chancery with allegations that directors failed to monitor properly "business risk" resulting from a corporation's heavy exposure to the subprime lending market. Mindful of the vital risk-taking function of directors and emphasizing the continued viability of the business judgment rule in the business risk oversight setting, the Court in *Citigroup* refused to interpret *Caremark* in a manner that would subject the directors to judicial second-guessing of the company's investment decisions absent conflict or other extreme reasons for doing so.

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The *Citigroup* case centered on massive subprime-related losses experienced by banking giant Citigroup Inc. ("Citigroup") during the 2007 credit crisis. Plaintiffs, the owners of Citigroup stock, asserted *Caremark* claims against the Company's directors, alleging they had breached their oversight duties by failing to monitor properly and manage Citigroup's subprime risk. Because their oversight claims did not challenge a particular business decision, plaintiffs argued that demand should be excused as "futile" given the "substantial likelihood of personal liability" faced by the directors in having failed to monitor properly Citigroup's subprime risk.[11] Noting that "demand will be excused based on a possibility

6. 976 A.2d 132 (Del. 2009).

7. 2010 WL 1931084 (Del. Ch. May 13, 2010).

8. 698 A.2d 959 (Del. Ch. 1996).

9. *Id*. at 970.

10. 964 A.2d 106 (Del. Ch. 2009).

11. *Id*. at 121; *see also* Rales v. Blasband, 634 A.2d 927, 933-34 (Del. 1993) (addressing the requisite demand futility analysis for derivative actions that do not involve challenges to an affirmative business decision of the board).

of personal director liability only in the rare case when a plaintiff is able to show director conduct that is 'so egregious on its face that board approval cannot meet the test of business judgment, and a substantial likelihood of director liability therefore exists,'"[12] the Court turned to *Caremark* and the specifics of plaintiffs' oversight allegations.

As summarized by the Supreme Court in *Stone v. Ritter*,[13] director oversight liability under *Caremark* requires one of two showings: (i) that "'the directors utterly failed to implement any reporting or information system or controls'" or (ii) "'having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention.'"[14] A showing of "bad faith" is thus a "necessary condition" to oversight liability as "a plaintiff must show that the directors *knew* they were not discharging their fiduciary obligations or that the directors demonstrated a *conscious* disregard for their responsibilities such as by failing to act in the face of a known duty to act."[15]

Unlike traditional *Caremark* allegations that the directors failed to monitor employee misconduct or violations of law (*i.e.*, regulatory risk or compliance oversight), the plaintiffs in *Citigroup* sought to hold the defendant directors liable for failing to monitor adequately Citigroup's "business risk." In particular, the Court distilled plaintiffs' theory to one that the directors should be held liable because they failed to appreciate the risk associated with Citigroup's subprime investments which, in hindsight, turned out poorly. But such claims fall within traditional process-based duty of care and business judgment rule analysis, which is not displaced (or diminished) in the *Caremark* oversight context:

> Business decision-makers must operate in the real world, with imperfect information, limited resources, and an uncertain future. To impose liability on directors for making a "wrong" business decision would cripple their ability to earn returns for investors by taking business risks. Indeed, this kind of judicial second guessing is what the business judgment rule was designed to prevent, and even if a complaint is framed under a *Caremark* theory, this Court will not abandon such bedrock principles of Delaware fiduciary duty law.[16]

Indeed, the Court found that fundamental differences between business risk oversight and traditional *Caremark* cases required plaintiffs to overcome even higher hurdles[17] in business risk oversight cases:

> While it may be tempting to say that directors have the same duties to monitor and oversee business risk, imposing *Caremark*-type duties on directors to monitor business risk is fundamentally different .... To impose oversight liability on directors for failure to monitor "excessive" risk would involve courts in conducting hindsight evaluations of decisions at the heart of the business judgment of directors.

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12. *Citigroup*, 964 A.2d at 121 (quoting Aronson v. Lewis, 473 A.2d 805, 815 (Del. 1984)).

13. 911 A.2d 362 (Del. 2006).

14. *Citigroup*, 964 A.2d at 123 (quoting *Stone*, 911 A.2d at 370).

15. *Id*. (emphasis in original).

16. *Id*. at 126.

17. As explained by the Court, "the burden required for a plaintiff to rebut the presumption of the business judgment rule by showing gross negligence is a difficult one, and the burden to show bad faith is even higher." *Id*. at 125. And as noted in the *Caremark* decision, "director liability based on the duty of oversight 'is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.'" *Id*. (quoting *Caremark*, 698 A.2d at 967).

> Oversight duties under Delaware law are not designed to subject directors, even expert directors, to personal liability for failure to predict the future and to properly evaluate business risk.[18]

Plaintiffs' specific allegations fell short of this substantial burden. Because Citigroup's certificate of incorporation included an exculpatory provision adopted pursuant to Section 102(b)(7) of the DGCL and there was no argument that the directors were conflicted or otherwise acted disloyally in failing to monitor Citigroup's subprime risk, plaintiffs were required to allege "bad faith." Plaintiffs invoked various "warning signs" in the public domain indicating worsening conditions that allegedly should have alerted the directors to the impending risks associated with Citigroup's subprime investments. But nothing about the so-called "red flags" supported the conclusion that the directors should have been aware of the impending losses or, more particularly, that they had "consciously" disregarded any warnings. And having acknowledged the establishment by Citigroup of procedures and controls designed to monitor risk, including an Audit and Risk Management Committee (the "ARM Committee") populated by a majority of the director defendants and charged with monitoring Citigroup's risk (thus negating the first basis for *Caremark* liability),[19] plaintiffs were unable to attack those controls as inadequate.[20]

In short, the Court refused to accept plaintiffs' invitation "to conclude from the presence of these 'red flags' … that the directors failed to see the extent of Citigroup's business risk and therefore made a 'wrong' business decision by allowing Citigroup to be exposed to the subprime mortgage market."[21] In so doing, the Court contrasted the oversight claims before it with those at issue in *American International Group, Inc. Consolidated Derivative Litigation*,[22] which involved factual allegations of "'pervasive, diverse, and substantial financial fraud involving managers at the highest levels.'"[23] *AIG*, unlike *Citigroup*, concerned the alleged failure to oversee "pervasive *fraudulent* and *criminal* conduct," and "the complaint there supported the assertion that top AIG officials[, certain of whom also served as AIG directors,] were leading a 'criminal organization' and that '[t]he diversity, pervasiveness, and materiality of the alleged financial wrongdoing at AIG [wa]s extraordinary.'"[24] Plaintiffs' oversight claims in *Citigroup* were accordingly dismissed as insufficient to excuse demand.[25]

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18. *Id*. at 131.

19. *See* text accompanying *supra* note 14.

20. The Court refused to hold the director members of the ARM Committee to a higher standard of care, explaining that "[d]irectors with special expertise are not held to a higher standard of care in the oversight context simply because of their status as an expert." *Citigroup*, 964 A.2d at 128; *but see id*. (reaffirming the holding of *Emerging Communications, Inc. Shareholders Litigation*, 2004 WL 1305745, at *39-40 (Del. Ch. May 3, 2004), that "[e]valuating director action under the bad faith standard is a contextual and fact specific inquiry and what a director knows and understands is, of course, relevant to such an inquiry").

21. *Id*. at 130.

22. 2009 WL 366613 (Del. Ch. Feb. 10, 2009).

23. *Citigroup*, 964 A.2d at 130 (quoting *AIG*, 2009 WL 366613, at *3).

24. *Id*. (quoting *AIG*, 2009 WL 366613, at *3). The Court also emphasized that the allegations in *AIG* were analyzed "under the plaintiff-friendly standard of Rule 12(b)(6), rather than the particularized pleading standard of Rule 23.1." *Id*. at 130 n.75.

25. Also noteworthy was *Citigroup*'s holding that plaintiffs had adequately pled demand futility with respect to their claim that the directors had committed "corporate waste" in approving an agreement with Citigroup's CEO that entitled him to $68 million and other benefits upon his retirement. *See id*. at 139. After acknowledging the "difficult" and "stringent requirements" to state a claim for corporate waste and adequately plead demand excusal for such claims, the Court explained that a "'plaintiff must overcome the general presumption of good faith by showing that the board's decision was so egregious or irrational that it could not have been based on a valid assessment of the corporation's best interests.'" *Id*. at 136 (quoting White v. Panic, 783 A.2d 543, 554 (Del. 2001)). While

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II. *SELECTICA, INC. V. VERSATA, INC.*

Shareholder rights plans, or "poison pills" as they are commonly referred to, emerged as popular defensive measures in the hostile takeover era of the 1980s. *Selectica, Inc. v. Versata, Inc.*[26] addressed the next generation of rights plans in upholding the adoption and use of a plan aimed at preserving potentially valuable net operating losses ("NOLs") – as distinct from seeking to deter an unfriendly suitor – perceived to be threatened by a shareholder's open market purchases of the corporation's stock. While *Selectica* was not the Court of Chancery's first foray into the world of poison pills, it marked the first time the Court sustained the triggering of a modern pill. Like the above described deference accorded the directors of Citigroup with respect to their monitoring of the company's business risk, *Selectica*'s upholding of a 4.99% threshold pill intended to protect an asset with admittedly "speculative" and "questionable" value underscores the great deference – and substantial flexibility – afforded independent and disinterested directors in this context, especially where such directors are well advised and informed.

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Selectica involved three corporate players: Selectica, Inc. ("Selectica"), a Delaware corporation providing enterprise software solutions for contract management and sales configuration systems; Trilogy, Inc., a Delaware corporation also specializing in enterprise software solutions that was a competitor of Selectica; and Versata Enterprises, Inc. ("Versata"), a Delaware corporation providing technology powered business services to clients.[27] Versata was a subsidiary of Trilogy, Inc. and together, the two (referred to collectively in *Selectica* and herein as "Trilogy") owned more than 6% of Selectica's outstanding common stock before intentionally triggering the rights plan in question.

Selectica was a struggling microcap company whose value consisted primarily of its cash reserves, intellectual property portfolio, customer and revenue base, and an estimated $160 million in NOLs. The NOLs were generated over the preceding several years due to substantial losses and the failure to turn an annual profit since going public in March 2000.[28] Following previously rebuffed expressions of interest by Trilogy concerning an acquisition of Selectica, Trilogy

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executive compensation decisions fall within the authority of directors, "the discretion of directors in setting executive compensation is not unlimited" and "the Delaware Supreme Court was clear when it stated that 'there is an outer limit' to the board's discretion to set executive compensation, 'at which point a decision of the directors on executive compensation is so disproportionately large as to be unconscionable and constitute waste.'" *Id*. at 138 (quoting Saxe v. Brady, 184 A.2d 602, 610 (Del. Ch. 1962)). Plaintiffs' allegations raised a reasonable doubt as to whether the exit package exceeded that "outer limit" and the case continued on that limited basis. *Id*.

26. 2010 WL 703062 (Del. Ch. Feb. 26, 2010). The Supreme Court of Delaware issued an opinion affirming this decision on October 4, 2010. *See* Versata Enters., Inc. v. Selectica, Inc., No. 193, 2010 (Del. Oct. 4, 2010) (not available on Westlaw or Lexis as of this Article's publication). Other than clarifying the test for "preclusion" under Delaware law (*see infra* note 48), the Supreme Court opinion embraced all aspects of the Court of Chancery's analysis.

27. The parties' dispute was preceded by an acrimonious relationship resulting from, among other things, Trilogy's (or affiliates of Trilogy) having sued Selectica for alleged patent infringement on two separate occasions. *See Selectica*, 2010 WL 703062, at *2.

28. "NOLs are tax losses realized and accumulated by a corporation that can be used to shelter future (or immediate past) income from taxation." *Id.* at *1. But because their value depends upon the company's future profitability before they expire in 20 years, NOLs are considered contingent assets whose value is impossible to determine. *Id.* Also important to understanding NOLs (and the dispute in *Selectica*) are the limitations imposed on NOLs by the IRS which seek to deter corporate taxpayers from benefiting from NOLs generated by other entities. Specifically, Internal Revenue Code section 382 limits the use of NOLs in periods following an "ownership change" that, while complicated to calculate, only involves shareholders holding 5% or more of a corporation's outstanding shares. *See id*. at *3.

began acquiring Selectica shares on the open market in the fall of 2008 and informed Selectica in November of that year that it had amassed more than 5% of Selectica's outstanding stock.

Concerned that such acquisitions might threaten Selectica's NOLs, the Selectica board (the "Selectica Board") – which was comprised of four independent and disinterested directors during the relevant period – met "to gauge the impact of these acquisitions, if any, on Selectica's NOLs, and to determine whether anything needed to be done to mitigate their effects."[29] The Selectica Board, with the assistance of its investment banker, an outside tax advisor retained to evaluate Selectica's NOLs,[30] and Delaware counsel, considered – and ultimately decided to adopt – an amendment to Selectica's existing rights plan that would lower the threshold trigger from 15% to 4.99% (the "NOL Pill").[31] The 4.99% trigger was driven largely by the 5% "ownership change" threshold established by the IRS.

Purportedly "to 'bring accountability' to the [Selectica] Board and 'expose' [its allegedly] 'illegal behavior' … in adopting a pill with such a low trigger," Trilogy intentionally "bought through" the NOL Pill the following month, increasing its total ownership share in Selectica to 6.7% and becoming an "Acquiring Person" under the NOL Pill.[32] The Selectica Board met seven times during the ten-day period provided for under the NOL Plan and received numerous presentations from its financial, accounting and legal advisors concerning the effect of Trilogy's stockholdings on Selectica's NOLs. During that period, Selectica also repeatedly (and unsuccessfully) attempted to secure a standstill from Trilogy concerning any additional purchases while the Selectica Board assessed whether Trilogy should be exempted from the NOL Pill.

An independent committee of the Selectica Board ultimately confirmed the findings of the directors and their experts that "the NOLs were a valuable corporate asset and that they remained at significant risk of being impaired."[33] The committee "concluded that Trilogy should not be deemed an 'Exempt Person,' that its purchase of additional shares should not be deemed an 'Exempt Transaction,' that an exchange of rights for common stock (the 'Exchange') should occur, and that a new rights dividend on substantially similar terms ought to be adopted."[34] Those decisions were based on the committee's conclusions that:

> Trilogy's actions … "were very harmful to the Company in a number of respects," and that "implementing the exchange was reasonable in relation to the threat imposed by Trilogy," in particular, because the NOLs were seen as "an important corporate asset that could significantly enhance stockholder value," and because Trilogy had intentionally triggered the NOL Pill, publicly suggested it might purchase

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29. *Id*. at *6.

30. The outside tax advisor, which specialized in NOL calculations, had analyzed Selectica's NOLs for the Selectica Board since March 2007. *See id.* at *3.

31. The NOL Pill grandfathered in existing 5% shareholders such that they were permitted to acquire up to an additional 0.5% (subject to the original 15% cap) without triggering the plan. *See id*. at *7. The NOL Plan also provided that the underlying rights would flip in ten business days after any shareholder became an "Acquiring Person" unless the Selectica Board either granted an exemption or exchanged the rights for common stock. Importantly, the NOL Pill conditioned the Selectica Board's ability to exempt an Acquiring Person upon a determination that the shareholder's ownership "would not 'jeopardize or endanger the availability to the Company of the NOLs….'" *Id.* at *8.

32. *Id*.

33. *Id*. at *10.

34. *Id*. at *11.

additional stock, and had refused to negotiate a standstill agreement, despite the fact that an additional 10% acquisition by a 5% shareholder would likely trigger an ownership change under Section 382.[35]

Framing the "principal question" as "the reasonableness of a board's adoption of a low-threshold poison pill in order to protect assets of speculative and questionable value absent an explicit plan for how such value might be realized,"[36] the Court assessed Selectica's adoption and use of the NOL Plan under enhanced *Unocal* scrutiny.[37]

The Court initially evaluated whether the Selectica Board should be afforded "material[ly] enhance[d]" deference under *Unocal* for defensive measures implemented by a majority of outside directors.[38] While the Selectica Board did not meet the specific requirements for this protection, the Court held that "any concern that the [Selectica] Board's actions stem[med] from a desire for entrenchment [wa]s seemingly groundless" and concluded "that there [wa]s sufficient evidence to find good faith and reasonable investigation by the [Selectica] Board here."[39]

Addressing the first prong of *Unocal*, the Court found that the Selectica Board had acted reasonably in concluding that the NOLs comprised a potentially valuable asset that was threatened by Trilogy's purchases of Selectica shares. Notwithstanding the "speculative" and "questionable" value of the NOLs to Selectica, the Court was satisfied that the Selectica Board, relying on the advice of multiple outside experts, "was reasonable in concluding that Selectica's NOLs were worth preserving and that Trilogy's actions presented a serious threat to their impairment."[40]

The Court next turned to the second prong of *Unocal*, which "requires an evaluation of whether a board's defensive response to the threat was preclusive or coercive and, if not, whether it was 'reasonable in relation to the threat' identified."[41] In assessing the preclusivness of the NOL Plan's 4.99% trigger,[42] the Court explained that "[a] defensive

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35. *Id*. at *9. The Exchange doubled the number of Selectica shares owned by all shareholders other than Trilogy and effectively diluted Trilogy's holdings from 6.7% to 3.3%. *See id*.

36. *Id*. at *11.

37. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985) (holding that before a board's defensive measures will be accorded the protections of the business judgment rule the directors must first satisfy a two-step reasonableness test). Referred to as "enhanced judicial scrutiny," Unocal requires directors to demonstrate both that "they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and that the "defensive measure [undertaken in response thereto was] reasonable in relation to the threat posed." *Id*. at 955; *see also* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1373 (Del. 1995) (expanding the Unocal doctrine by holding that a board's action need only fall within a "range of reasonableness" to be upheld so long as the defensive measure at issue is not "coercive or preclusive").

38. Specifically, *Unocal* held that "where the defensive actions were taken by 'a majority of outside directors,' proof of the board's good faith and reasonable investigation is 'materially enhanced.'" *Selectica*, 2010 WL 703062, at *12 (quoting *Unocal*, 493 A.2d at 955). In contrast to the "'subjective "actual person" standard' [applied] in considering the question of director independence," *id*. at *13 (citation omitted), Delaware courts define an "outside" director "as 'a non-employee and non-management director' that 'receiv[es] no income other than usual directors' fees….'" *Id*. (quoting *Unitrin*, 651 A.2d at 1375; Moran v. Household Int'l, Inc., 490 A.2d 1059, 1074-75 (Del. 1995)). Two of Selectica's four directors therefore could not be considered "outside" directors in light of their roles as Co-Chairs of Selectica during the events at issue (a position acknowledged by Selectica to be akin to that of a CEO) and the additional compensation they received in connection with those roles. *Id*. The Court nevertheless concluded that "although nominally not outside directors, the record suggest[ed] both were … independent." *Id*. at *14.

39. *Id*. at *15.

40. *Id*. at *19; *see also id*. ("In order to conclude that a serious threat existed, the [Selectica] Board needed only reasonably conclude that the NOLs were a legitimate asset worth protecting.").

41. As explained by the Court, "[i]t is the specific nature of the threat that 'sets the parameters for the range of permissible defensive tactics.'" *Id.* (quoting *Unocal*, 493 A.2d at 955).

42. The parties agreed that the challenged actions of the Selectica Board were not coercive. *See id*. at *20 n.169.

measure is preclusive where it 'operate[s] to unreasonably preclude a takeover' or 'preclude[s] effective stockholder action' —specifically, where the measure 'makes a bidder's ability to wage a successful proxy contest and gain control either "mathematically impossible" or "realistically unattainable."'"[43] Indeed, "[p]reclusive measures are those that are 'insurmountable or impossible to outflank.'"[44]

While Trilogy's expert had opined that a pill with a less than 5% trigger "'has a substantial preclusive effect,'" the Court credited numerous examples of less than 5.49% shareholders that had been successful in waging proxy contests for control of microcap companies like Selectica[45] and held that the actions of the Selectica Board were not draconian given that "[s]uch a high standard operates to exclude only the most egregious defensive responses."[46] Indeed, the Court made clear that it is not enough that a defensive measure make a proxy contest "more difficult—even considerably more difficult."[47] To be preclusive, a defensive "measure must render a successful proxy contest a near impossibility or else utterly moot."[48]

With respect to the reasonableness inquiry, the Court explained that "[u]ltimately, *Unocal* and its progeny require that the defensive response employed be a proportionate response, not the most narrowly or precisely tailored one."[49] As

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43. *Id*. at *20 (quotations omitted).

44. *Id*. (quoting Gaylord Container Corp. S'holders Litig., 753 A.2d 462, 482 (Del. Ch. 2000)).

45. This conclusion applied with particular force to Selectica given the concentration of holdings of its stock, a majority of which was owned by Selectica's seven largest investors. *See id*. at *21; *see also id*. at *2 (noting that fewer than twenty-five investors held nearly two-thirds of Selectica's stock).

46. *Id*. at *21.

47. *Id*.

48. *Id*. A subsequent decision of the Court of Chancery issued shortly before the publication of this Article questioned this formulation in upholding the adoption and employment of a shareholder rights plan by the board of directors of Barnes & Noble in response to an anticipated proxy contest. *See* Yucaipa Am. Alliance Fund II, L.P. v. Riggio, 2010 WL 3170806 (Del. Ch. Aug. 12, 2010). Specifically, the Court held "that if a defensive measure does not leave a proxy insurgent with a fair chance for victory, the mere fact that the insurgent might have some slight possibility of victory does not render the measure immune from judicial proscription as preclusive." *See Yucaipa,* 2010 WL 3170806, at *18 n.182. According to the *Yucaipa* Court:

> if the terms of a rights plan, which already has the powerful effect of barring the direct door to an acquisition, in themselves have the effect of rendering a victory for an insurgent improbable, the proportionality prong of the *Unocal* test should require the board to make an extremely strong showing why the rights plan should be sustained.

Id.

While the Supreme Court in *Versata* did not address the *Yucaipa* Court's relaxed preclusivity standard, it relied on *Unitrin* for the proposition that "[a] defensive measure is preclusive where it 'makes a bidder's ability to wage a successful proxy contest and gain control either "mathematically impossible" or "realistically unattainable."'" *Versata* Op. at 36 (quoting Carmody v. Toll Bros., Inc., 723 A.2d 1180, 1195 (Del. Ch. 1998); Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1389 (Del. 1995)). Reasoning that "[a] successful proxy contest that is mathematically impossible is, *ipso facto*, realistically unattainable" and that "the 'mathematically impossible' formulation in *Unitrin* is subsumed within the category of preclusivity described as 'realistically unattainable,'" the Supreme Court in *Versata* held that "there is, analytically speaking, only one test of preclusivity: 'realistically unattainable.'" *Id.* The Supreme Court has apparently lowered the preclusivity standard for future pill challengers by departing from the Court of Chancery's "near impossibility or else utterly moot" formulation. How the "realistically unattainable" formulation will be applied going forward and the extent to which any such application will meaningfully differ from the "near impossibility" one is difficult to predict. The "realistically unattainable" standard does, however, seemingly exceed the "fair chance" and "improbable" threshold articulated by the Court of Chancery in *Yucaipa*.

49. *Selectica,* 2010 WL 703062, at *24.

such, the issue is not whether the response was "perfect," only whether it was "reasonable."[50] If the directors select one of several reasonable responses, that choice will not be second guessed by the courts.[51] The actions of the Selectica Board were found to be reasonable, in part due to the fact that "the [4.99%] threshold, low as it is, was measured by reference to an external [tax] standard …."[52]

As the foregoing makes clear, a robust process and the deference accorded the unconflicted directors here was key: "the [Selectica] Board reasonably believed, based on the guidance of appropriate experts, that the NOLs had value, a value worth protecting."[53] While the Selectica Board may have been incorrect "[i]n its view of the actual value of the NOLs," it was not appropriate for the Court "to substitute its judgment for the reasonable conclusions of the Board protected as they are by 8 Del. C. § 141(e)."[54]

III. *LYONDELL CHEMICAL CO. V. RYAN*

The Supreme Court refined *Unocal* in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[55] where the Court required directors of target companies selling corporate control to seek the highest price reasonably attainable for the shareholders.[56] Colloquially referred to as "*Revlon* duties,"[57] the Delaware courts have recognized that there is no single blueprint that directors must follow to fulfill their responsibilities in this setting; rather, boards must engage in a reasonable – not perfect – process designed to achieve the highest price for stockholders. The Supreme Court of Delaware revisited *Revlon* in *Lyondell Chemical Co. v. Ryan*[58] and clarified a number of important aspects of this doctrine, including when *Revlon* duties arise, the absence of any specific steps that directors must take when determining to embark on a sale of control transaction, and the heavy deference afforded independent and disinterested directors in this setting. As explored below, the Supreme Court's adoption of a standard requiring challengers to demonstrate that the directors "utterly failed to obtain the best price" significantly raises the bar for plaintiffs seeking to establish that independent and disinterested directors failed to comport with their *Revlon* duties.

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50. *Id*. (quoting Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 45 (Del. 1994)).

51. *See id.*

52. *Id.*; *see also supra* note 28.

53. *Selectica*, 2010 WL 703062, at *24.

54. *Id*.

55. 506 A.2d 173 (Del. 1986).

56. *See id*. at 182; *see also* In re Topps Co. S'holders Litig., 926 A.2d 58, 64 (Del. Ch. 2007) ("When directors propose to sell a company for cash or engage in a change of control transaction, they must take reasonable measures to ensure that the stockholders receive the highest value reasonably attainable.").

57. While referred to as "*Revlon* duties," there are "no special and distinct '*Revlon* duties'" other than "to get the highest value reasonably attainable for the shareholders." Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1288 (Del. 1989); *see also* Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989) ("[T]he basic teaching … is simply that the directors must act in accordance with their fundamental duties of care and loyalty.").

58. 970 A.2d 235 (Del. 2009).

Lyondell involved a stockholder challenge to the cash merger between Lyondell Chemical Company ("Lyondell"), a Delaware corporation and the then third largest publically traded chemical company in North America, and Basell AF ("Basell"), a privately-held Luxembourg company in the polyolefin business that was indirectly owned by Leonard Blavatnik ("Blavatnik") through his control of Access Industries ("Access"). Lyondell had an eleven member board (the "Lyondell Board") comprised of ten independent – and experienced – directors and Dan Smith ("Smith"), Lyondell's Chairman and CEO.

Blavatnik informed Smith in April 2006 of Basell's interest in acquiring Lyondell and sent a letter to the Lyondell Board a few months later offering $26.50 - $28.50 per share. The Lyondell Board determined that Lyondell was not for sale and rejected Basell's proposal as inadequate. In May 2007, an affiliate of Access filed a Schedule 13D with the SEC disclosing its interest in a possible transaction with Lyondell and intention to acquire an 8.3% block of Lyondell stock owned by Lyondell's second largest shareholder. Lyondell's stock jumped more than 10% the day the 13D was made public.

The Lyondell Board concluded the following day that the 13D signaled to the market that Lyondell was "in play." It nevertheless decided to take a "wait and see" approach and did not respond to or otherwise prepare for a possible proposal. Smith was subsequently approached – and rejected an expression of interest – by Apollo Management, L.P. concerning a management-led LBO a few days later. No other expressions of interest from potential bidders materialized. Basell temporarily turned its attention to a transaction with specialty chemical company Huntsman Corporation ("Huntsman"), but refocused on Lyondell after Hexion Specialty Chemicals, Inc. ("Hexion") made a topping bid for Huntsman.[59]

Blavatnik met with Smith on July 9, 2007 to discuss an all-cash acquisition by Basell of Lyondell for $40 per share. Blavatnik raised his offer price to $44 - $45 after Smith dismissed the $40 offer as too low. While Smith agreed to take the $44 - $45 proposal to the Lyondell Board, he cautioned that the proposal would be rejected by Lyondell's directors and invited Blavatnik to make his best offer. The two agreed to speak later that day at which point Blavatnik proposed a transaction with a $48 per share price, no financing contingency, and a $400 million break-up fee in favor of Basell. Basell also conditioned its proposal on a merger agreement being signed by July 16, 2007.

The Lyondell Board held a special meeting for approximately 50 minutes the following day to address Blavatnik's proposal. The directors reviewed valuation material that had been prepared by management for a regularly scheduled board meeting and discussed the Basell offer, the status of the Huntsman merger, and the likelihood that another acquiror might be interested in Lyondell. Smith was instructed to obtain a written offer from Basell with more details about its financing.

Blavatnik agreed to do so but requested that the Lyondell Board provide a firm indication of interest given the existence of a July 11 deadline for Basell to make a higher bid for Huntsman. The Lyondell Board considered that request and the Basell offer at its regularly scheduled meeting on July 11, which lasted approximately 45 minutes. Deciding that it was interested in pursuing a transaction with Basell, the Lyondell Board authorized the retention of Deutsche Bank as Lyondell's financial advisor and instructed Smith to negotiate with Blavatnik.[60]

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59. While outside the scope of this Article, Hexion's attempt to terminate its eventual $10.6 billion merger agreement with Huntsman spawned a leading "material adverse affect" ("MAE") decision in Delaware. *See* Hexion Specialty Chems., Inc. v. Huntsman Corp., 2008 WL 4457544 (Del. Ch. Sept. 29, 2008). In that case, Hexion could not carry its "heavy burden" of demonstrating that Huntsman had suffered a MAE as that term was defined in the governing merger agreement. A "'short-term hiccup'" is not enough, as a MAE requires unknown events that substantially threaten the long-term earnings of the company. *Id.* at *15 (quoting In re IBP, Inc. S'holders Litig., 789 A.2d 14, 68 (Del. Ch. 2001)). A party claiming a MAE therefore must demonstrate that there has been "an adverse change in the target's business that is consequential to the company's long-term earnings power over a commercially reasonable period, which one would expect to be measured in years rather than in months." *Hexion*, 2008 WL 4457544, at *15.

60. Basell announced as a result that it would not raise its offer for Huntsman and Huntsman terminated the parties' merger agreement. *See Lyondell*, 970 A.2d at 238.

The parties negotiated a merger agreement between July 12 to July 15, during which time Basell conducted due diligence and Deutsche Bank prepared a fairness opinion. The Lyondell Board discussed the Basell proposal again on July 12 and instructed Smith to test the waters on the prospect of better terms, including a higher price, a go-shop provision, and a reduced break-up fee. Having offered his best price and resolute in his insistence that the deal be signed up by July 16, Blavatnik rejected Smith's proposals (although as a sign of good faith agreed to reduce the break-up fee from $400 million to $385 million).

The Lyondell Board met to consider the negotiated merger agreement on July 16 and received presentations from management and its financial and legal advisors on the merits of the deal. In opining that the $48 per share deal price was fair, Deutsche Bank noted that the price – which reflected a 45% premium – was so favorable that it fell outside a number of its valuation ranges and its managing director characterized the price as "an absolute home run."[61] Deutsche Bank also expressed its conclusion that Basell's offer would not be topped by another acquiror. The Lyondell Board subsequently approved and recommended the merger to Lyondell's shareholders, who approved the transaction at a special stockholder meeting with the holders of 65.8% of the total outstanding common stock voting in favor of the merger.

A Lyondell shareholder filed a class action suit against Lyondell's directors alleging they had breached their fiduciary duties given that the $48 merger price was "grossly insufficient" and they had approved the merger "for their own self-interest," employed a "flawed" merger negotiation process, agreed to "unreasonable" deal protection measures, and issued an incomplete and misleading proxy statement. Notably, and uncharacteristically for these types of claims, the plaintiff-shareholder did not seek to enjoin the merger and the case came before the Court of Chancery on defendants' motion for summary judgment.

The Court of Chancery granted defendants' motion in all respects except for plaintiffs' process and deal protection claims, which the Supreme Court characterized as "but two aspects of a single claim, under *Revlon* … that the directors failed to obtain the best available price in selling the company."[62] Given the inclusion of a section 102(b)(7) provision in Lyondell's certificate of incorporation exculpating pure duty of care claims and the absence of any allegations that the directors lacked independence or disinterestedness, the sole issue on the motion for summary judgment was whether Lyondell's directors had breached their fiduciary duties of loyalty by failing to act in good faith.

Given the procedural posture of defendants' summary judgment motion, where all reasonable inferences had to be drawn in plaintiffs' favor, the Court of Chancery found that defendants' "'two months of slothful indifference despite *knowing* that the Company was in play'" following Basell's Schedule 13D raised factual issues as to whether the directors had conducted the sales process in "bad faith."[63] Indeed, the Court of Chancery's opinion repeatedly emphasized that its ruling was driven by the governing summary judgment analysis.[64]

61. *Id*. at 239.

62. *Id*.

63. *Id*. at 241 (quoting the opinion of the Court of Chancery below).

64. *See* J. Travis Laster & Steven M. Haas, *Reactions and Overreactions to* Ryan v. Lyondell Chemical Co., 22 Insights: Director Liability 9, 12 (Sept. 2008) ("Practitioners must recognize, however, that the *Lyondell* opinion was driven by its procedural posture, which was a decision on summary judgment. The summary judgment standard requires the court to draw 'all reasonable inferences … in favor of the non-moving party' and allows dismissal only when there is 'no genuine issue of fact.' Vice Chancellor Noble mentioned this repeatedly, starting on the first page of the opinion and again and again when he declined to adopt arguments made by the defendants. In this regard, *Lyondell* stands in sharp contrast to the majority of Delaware M&A opinions that are decided on motions for preliminary injunction [where] the court must determine whether the plaintiff has a reasonable probability of success on the merits (in addition to evaluating irreparable harm and the balance of hardships.")).

Having taken the rare action of granting defendants' interlocutory appeal from a decision denying summary judgment, the Supreme Court took the even rarer action of not only reversing the Court of Chancery but also entering summary judgment in favor of the defendant directors. In so doing, the Supreme Court decided precisely when *Revlon* duties arose. Specifically, the Court held that *Revlon* duties arise not when a company is put in play (such as in the case of *Lyondell* upon Basell's filing of its Schedule 13D), but "when a company embarks on a transaction – on its own initiative or in response to an unsolicited offer – that will result in a change of control."[65] Here, the Supreme Court held that *Revlon* duties did not arise until Lyondell's directors actually began negotiating the sale of Lyondell. As a result, the adoption of a "wait and see" strategy to unsolicited bids was subject to the deferential business judgment rule, and the fact that the Lyondell Board failed to seek competing offers or other bidders during the two months following Basell's Schedule 13D filing was immaterial to the good faith calculus. *Revlon* duties instead arose on "July 10, 2007, when the directors began negotiating a sale of Lyondell" making the relevant timeframe "the one week during which they considered Basell's offer."[66]

The Supreme Court also focused upon the affirmative actions of the directors (*i.e*., what they did), not what they *did not* do. While the Court of Chancery repeatedly emphasized the procedural posture before it and, specifically, that the failure of the Lyondell Board to respond in any way following the Basell 13D raised an issue of fact as to whether the directors had done everything to get the best price, the Supreme Court defined the issue as a legal one of good faith as opposed to due care "where the analysis is very different."[67] Recounting its discussion of bad faith in *Disney*, the Court explained that "bad faith will be found if a 'fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties.'"[68] Because "there are no legally prescribed steps that directors must follow to satisfy their *Revlon* duties," the failure to take particular actions during a sale could not demonstrate conscious disregard.[69] Insofar as "[d]irectors' decisions must be reasonable, not perfect," "'extreme'" facts are "'required to sustain a disloyalty claim premised on the notion that disinterested directors were intentionally disregarding their duties.'"[70] In sum, "[o]nly if they knowingly and completely failed to undertake their responsibilities would they breach their duty of loyalty."[71]

Ultimately, the Supreme Court held that "[t]he trial court approached the record from the wrong perspective."[72] The issue was not whether the directors "did everything that they (arguably) should have done to obtain the best sale

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65. *Lyondell*, 970 A.2d at 242.

66. *Id*.

67. Indeed, the Court specifically noted that it "would not question the trial court's decision to seek additional evidence if the issue were whether the directors had exercised due care." *Id*. at 243.

68. *Id*. (quoting In re The Walt Disney Co. Deriv. Litig., 906 A.2d 27, 67 (Del. 2006)); *see also* Leo E. Strine, Jr., Lawrence A. Hamermesh, R. Franklin Balotti & Jeffery M. Gorris, *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 Geo. L.J. 629 (2010) (exploring the contours of good faith in the corporate context).

69. *Lyondell*, 970 A.2d at 243. Given this formulation, it is now arguably impossible for a plaintiff to show a bad faith breach because as a matter of logic there is no "known duty to act" that could be "consciously disregarded."

70. *Id*. at 243-44 (quoting Lear Corp. S'holder Litig., 2008 WL 4053221, at *11 (Del. Ch. Sept. 2, 2008)).

71. *Id*.

72. *Id*. at 244.

price," but whether they "utterly failed to attempt to obtain the best sale price."[73] The Supreme Court's granting of summary judgment on behalf of the defendants results from several key factors, including that: the consideration paid to Lyondell stockholders represented a 45% premium over the closing stock price of Lyondell immediately before disclosure of Basell's interest in Lyondell via the Schedule 13D; the transaction was approved by an independent and disinterested board advised by financial and legal advisors; and the merger was approved by the holders of over 65% of the company's outstanding common stock. The transaction thus represented a substantial premium, lacked any of the hallmark conflicted director or shareholder players that typically permeate these types of challenged deals, and garnered the resounding endorsement of the Lyondell shareholders. This confluence of factors was enough given the deferential analysis set forth by the Supreme Court.[74]

IV. *IN RE JOHN Q. HAMMONS HOTELS, INC.*

In contrast to the deference accorded independent and disinterested directors in change of control transactions under *Lyondell*, self-dealing mergers involving controlling shareholders are subjected to heightened entire fairness review to minimize the risk that minority shareholders will be inequitably exploited in such transactions.[75] Indeed, in *Kahn v. Lynch Communication Systems, Inc.*,[76] the Supreme Court declared entire fairness the "exclusive standard" for assessing mergers in which a controlling shareholder "stands on both sides" of the transaction.[77] Unanswered by *Lynch*, however,

73. *Id*. "Utterly failed" is a linguistically extreme formulation, and the Supreme Court did not indicate what might constitute "utter failure." Imagine a field goal kicker who misses wide right. He failed, but did he "utterly fail"? Certainly not: he tried and missed. But at what point does the failure become "utter"? If his foot missed the ball? He still would have attempted the kick, and thus would not have "knowingly and completely failed to undertake [his] responsibilities." What if he picks up the ball, tries to run and fumbles, or tries to pass and throws an interception? In both instances he has failed to attempt a kick, his core responsibility, but he did try to do something. If an attempt is all that matters, as the "utter failure" test suggests, then one can well wonder how a board ever could "utterly fail" in the change of control setting.

74. Two post-*Lyondell* decisions make clear that it will be significantly more difficult for a stockholder plaintiff under the heightened standard adopted by *Lyondell* to establish that an independent and disinterested board "utterly failed to obtain the best price." *See* In re NYMEX S'holder Litig., 2009 WL 3206051, at *7 (Del. Ch. Sept. 30, 2009) (dismissing *Revlon* claims against a board populated by twelve of fourteen "unquestionably independent" directors because plaintiffs failed to allege "that the Board 'utterly failed to obtain the best sale price'"); Wayne County Employees' Ret. Sys. v. Corti, 2009 WL 2219260, at *14 (Del. Ch. July 24, 2009) (framing "the relevant question [proclaimed by *Lyondell* a]s whether the Director Defendants '*utterly failed to attempt* to obtain the best sale price'" and dismissing *Revlon* claims against a board comprised of a majority of independent and disinterested directors) (emphasis in original).

75. The Court of Chancery in *Pure Resources* illustratively likened controlling shareholders in this setting – given the power wielded by such shareholders and the resultant "inherent coercion" vis-à-vis the minority – to that of an "800-pound gorilla whose urgent hunger for the rest of the bananas is likely to frighten less powerful primates like putatively independent directors who might well have been hand-picked by the gorilla (and who was at the very least owed their seats on the board to his support)." In re Pure Res. S'holders Litig., 808 A.2d 421, 436 (Del. Ch. 2002); *see also* David C. McBride & Michael W. McDermott, *The Rights and Duties of Controlling Shareholders: Learning to Dance with the 800 Pound Gorilla* (Feb. 23, 2005) (unpublished manuscript, on file with authors) (analyzing the rights and duties of controlling shareholders and the treatment by courts of controlling shareholder transactions in different transactional settings).

76. 638 A.2d 1110 (Del. 1994).

77. *Id*. at 1117; *see also* Kahn v. Tremont Corp., 694 A.2d 422 (Del. 1997) (extending *Lynch* to any transaction in which a controlling shareholder stands on both sides of the transaction). *Lynch* similarly clarified that while "[t]he initial burden of establishing entire fairness rests upon the party who stands on both sides of [such a] transaction," "approval of the transaction by an independent committee of directors *or* an informed majority of minority shareholders shifts the burden of poof on the issue of fairness from the

continued on page 14

was the extent to which entire fairness applied to mergers involving a controlling shareholder on only one side of the deal. Subsequent cases have also questioned the effect that properly employed procedural safeguards (*i.e.*, special committees and majority-of-the-minority shareholder approval conditions) should have on the standard of review for controlling shareholder transactions.[78] Many of these doctrinal issues were at the forefront in *In re John Q. Hammons Hotels Inc. Shareholder Litigation*,[79] which held that, absent both a properly empowered and functioning special committee *and* a majority-of-the-minority condition, entire fairness applies to a merger involving a controlling shareholder that does not stand on both sides of the underlying transaction but competes with the minority shareholders for a fixed amount of consideration and will have a continuing interest in the post-merger entity.

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Hammons involved the merger of John Q. Hammons Hotels, Inc. ("JQH") with an acquisition vehicle ("Acquisition") controlled by Jonathan Eilian ("Eilian") (the "JQH Merger"), a third party with no prior relationship to either

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controlling or dominating shareholder to the challenging shareholder-plaintiff … [as] an entire fairness analysis is the only proper standard of judicial review" in this setting. *Lynch*, 638 A.2d at 1117 (emphasis added). In so doing, *Lynch* resolved a split in the Court of Chancery concerning whether a controlling shareholder's use of either of these procedural safeguards, by itself, displaced entire fairness in favor of business judgment review for controlling shareholder transactions. *Compare* In re Trans World Airlines, Inc. S'holders Litig., 1988 WL 111271 (Del. Ch. Oct. 21, 1988) (holding that special committee approval was sufficient to invoke business judgment review), *with* Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490 (Del. Ch. 1990) (holding that neither special committee approval nor the informed vote of a majority-of-the-minority shareholders negated entire fairness review). As observed by the Court of Chancery in *In re Cox Communications, Inc. Shareholders Litigation*, 879 A.2d 604 (Del. Ch. 2005), "[f]rom a close reading of the *Citron* decision, one discerns that Vice Chancellor Jacobs felt the *Weinberger v. UOP, Inc*., 457 A.2d 701 (Del. 1983) and *Rosenblatt v. Getty Oil Co*., 493 A.2d 929, 937 (Del. 1985) [decisions] had already decided the key question and that he was bound to that determination." *Id*. at 616 n.24.

78. *See Cox Communications*, 879 A.2d at 644-45 (exploring *Lynch*'s failure to provide controlling shareholders with additional incentives to condition going-private mergers on minority shareholder approval and advocating a "modest alteration of *Lynch*" that would afford business judgment rule protection if the underlying transaction was "subject from inception to negotiation and approval … by an independent special committee *and* a Minority Approval Condition"); In re Cysive, Inc. S'holders Litig., 836 A.2d 531, 549-50 & n.23 (Del. Ch. 2003) (suggesting "that the *Lynch* doctrine, if it is to be perpetuated, could be usefully simplified" and noting the suggestion in other cases "that the business judgment rule standard of review ought to, at the very least, apply if a merger or other transaction with a controlling stockholder has been approved by a majority independent board *and* conditioned on a majority of the minority (*i.e*., disinterested) vote"); *Pure Resources*, 808 A.2d at 444 n.43 ("A slight easing of the *Lynch* rule would help level the litigation risk posed by the different acquisitions methods [in the controlling shareholder going-private transaction setting], and thereby provide an incentive to use the negotiated merger route. At the very least, this tailoring could include providing business judgment protection to mergers negotiated by a special committee and subject to majority of the minority protection."); *see also* William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 Bus. Law. 1287, 1306-09 (2001) (opining that *Lynch* "unintentionally created a disincentive to seek an approving 'majority of the minority' shareholder vote, because the acquired company's board can obtain the same protection by using the 'special committee' device as a 'cleansing' mechanism" and "question[ing] whether there [wa]s enough utility to justify continuing the stricter scrutiny of interested mergers that are approved by one or both of these intra-corporate 'cleansing procedures'"). Indeed, *Pure Resources* recognized that *Lynch* did not involve a self-dealing transaction in which the controlling shareholder had employed both a special committee and majority-of-the-minority condition and thus "it is arguable that the Supreme Court has never been asked to addresses the precise question that would be posed if a controller, from the inception of a transaction, made clear that its merger proposal was conditioned upon the use of both of these procedural protections …." *Pure Resources*, 808 A.2d at 435.

79. 2009 WL 3165613 (Del. Ch. Oct. 2, 2009).

JQH or John Q. Hammons ("Hammons") who was JQH's controlling shareholder. JQH, a Delaware corporation which owned and managed hotels, had two classes of stock: Class A common stock which was publicly traded and entitled to one vote per share (of which Hammons owned approximately 5%) and Class B common stock which was not publicly traded and entitled to fifty votes per share (of which Hammons owned 72%). In addition to controlling over 75% of JQH's total voting power, Hammons also served as JQH's CEO and the Chairman of JQH's eight member board of directors (the "JQH Board").

In early 2004, Hammons informed the JQH Board that he had begun discussions with third parties regarding a potential sale of his interest in JQH and the JQH Board formed a special committee "to evaluate and negotiate a proposed transaction on behalf of the unaffiliated stockholders and make a recommendation to the [JQH] Board."[80] The special committee, which plaintiffs conceded was independent and disinterested, retained both legal and financial advisors.[81]

After negotiations between the special committee and a prior suitor broke down, Eilian offered to acquire all of JQH's outstanding Class A common stock for $24 per share.[82] Eilian was granted exclusivity and representatives of Eilian, Hammons and the special committee spent several months negotiating a deal. In June 2005, Hammons and Eilian informed the special committee that they had reached an agreement. Eilian also reaffirmed its offer to purchase the Class A common stock for $24 per share.

The special committee met with its legal and financial advisors to consider the proposed transaction and, following presentations regarding the process preceding the transaction and the underlying merger consideration, approved the merger agreement and certain related agreements between Hammons and Eilian (with the Merger Agreement, the "Transaction Agreements"). The JQH Board met immediately thereafter and similarly approved the Merger Agreement.

The Merger Agreement entitled the holders of Class A common stock to $24 per share in cash, a significant premium to the $4 to $7 range at which the stock was trading at before rumors of a possible transaction surfaced. Hammons and Eilian (through Acquisition) additionally "entered into a series of other agreements [*i.e.*, the Transaction Agreements], which provided for a complex, multi-step transaction designed to provide Hammons financing to continue his hotel development activities [following the Merger] without triggering the tax liability associated with an equity or asset sale."[83] The Merger was conditioned on the approval of a majority of the unaffiliated Class A common stockholders voting on the transaction, although that approval was subject to wavier by the special committee.[84] Waiver was never an issue, however, as 72% of the outstanding shares of JQH's Class A common stock voted to approve the Merger.

80. *Id*. at *4.

81. Although the Court did not address the ultimate independence of the special committee's advisors, it noted the legal advisor's representation of an entity providing Eilian's financing in connection with the Merger and the financial advisor's unsuccessful attempt to participate in Eilian's refinancing of JQH's debt. *See id.* The Court also noted JQH's failure to disclose either of these conflicts in the proxy, implicitly questioning the advisors' independence. *See id*. at *8.

82. Eilian had met with the special committee regarding his interest in a possible transaction with JQH in November 2004 and submitted an acquisition proposal the following month, although Hammons was negotiating with a different party at that time and initially expressed an unwillingness to do a deal with Eilian "under any circumstances." *Id*. at *5.

83. Specifically, Hammons agreed to exchange his Class B common stock and controlling interest in a limited partnership through which JQH conducted its operations for (i) a 2% interest in the cash flow distributions and preferred equity of the surviving LP (with a company controlled by Eilian becoming the general partner of the LP and receiving the remaining 98% thereof), (ii) a preferred capital interest in the surviving LP with a total liquidation preference of $335 million, (iii) a $25 million short-term line of credit, (iv) a $275 million long-term line of credit, and (v) various other rights and contractual obligations, including an agreement whereby Hammons' "management entity would continue to manage the hotels in exchange for payments of actual operating costs and expenses incurred (estimated to be approximately $6.5 million based on the budget for 2005) and a $200,000 annual salary to Hammons, plus benefits." *Id*.

84. The Merger Agreement also included a termination fee capped at $20 million and a "no shop" provision that limited JQH's ability to solicit offers from other parties. *See id*. at *7.

Owners of JQH's Class A common stock filed suit on behalf of the non-Hammons Class A common stockholders challenging the Merger on the basis that Hammons breached his fiduciary duties in negotiating benefits for himself that were not shared with the minority shareholders. They also alleged, among other things, that JQH's directors breached their duties in permitting a "flawed" negotiation process and approving the "unfair" Merger.

The "threshold issue" for the Court on the parties' dueling motions for summary judgment was the applicability of the entire fairness standard of review.[85] Plaintiffs argued that because Hammons was not selling his interest, but instead "restructur[ing it] in a way that accomplished his tax and financial goals while maintaining a significant interest in the surviving company, in addition to other rights," entire fairness applied because he "stood on both sides" of the Merger.[86] The Court disagreed and in so doing refused to extend *Lynch* to the facts of this case.

The Court distinguished *Lynch* on the grounds that the minority shareholders in *Hammons* were entering into a transaction with "an unrelated third party," not the controlling shareholder.[87] To that end, the acquiror negotiated with the controlling shareholder separately from its negotiations with the independent special committee on behalf of the minority. It was thus irrelevant that Hammons retained an interest in the surviving company, as he did not "stand[] on both sides" of the transaction for purposes of mandatory application of entire fairness review under *Lynch*.[88]

The Court nevertheless held that entire fairness review would still apply unless the transaction was both "(1) recommended by a disinterested and independent special committee, *and* (2) approved by stockholders in a non-waivable vote of the majority of all the minority stockholders."[89] As explained by the Court:

> Although I have determined that Hammons did not stand "on both sides" of this transaction, it is nonetheless true that Hammons and the minority stockholders were in a sense "competing" for portions of the consideration Eilian was willing to pay to acquire JQH and that Hammons, as a result of his controlling position, could effectively veto any transaction. In such a case it is paramount—indeed, necessary in order to invoke business judgment review—that there be robust procedural protections in place to ensure that the minority stockholders have sufficient bargaining power and the ability to make an informed choice of whether to accept the third-party's offer for their shares.[90]

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85. "According to the now familiar words of [*Weinberger v. UOP, Inc.*], entire fairness has two aspects: fair dealing and fair price. This test, however, is not a 'bifurcated one between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness.'" Gesoff v. IIC Indus. Inc., 902 A.2d 1130, 1144 (Del. Ch. 2006) (quoting Weinberger v. UOP, Inc., 457 A.2d 701, 708 (Del. 1983)).

86. *Hammons*, 2009 WL 3165613, at *10.

87. *Id*.

88. *See Lynch*, 638 A.2d at 1117; *see also supra* note 77 (quoting and discussing same).

89. *Hammons*, 2009 WL 3165613, at *12. The Court's use and emphasis of "and" in formulating this construct provides an interesting and noteworthy contrast to *Lynch*'s use of the disjunctive in articulating the burden shifting consequences of *either* procedural safeguard in a self-dealing controlling shareholder transaction. *See supra* note 77. This formulation also arguably differs from the Court of Chancery's employment of traditional business judgment review in *Orman v. Cullman*, 794 A.2d 5 (Del. Ch. 2002), in assessing a controlling shareholder transaction in which the controller did not stand on both sides of the challenged transaction. *See id.* at 22 ("[A]though the Cullman Group was the controlling shareholder of the target company both before and after the merger, the Cullman Group did not stand on both sides of the challenged merger. Instead it was approached by, and began initial negotiations with, an unaffiliated third party, Swedish Match. A Special Committee of independent directors then completed those negotiations. Therefore, the burden remains on Orman to allege other facts sufficient to overcome the business judgment presumption.").

90. *Hammons*, 2009 WL 3165613, at *12.

Defendants' failure to satisfy this test precluded business judgment review. To provide sufficient protection, a majority-of-the-minority vote must be both nonwaivable and conditioned upon a majority of all minority shareholders—not just those voting.[91] But in this case, the majority-of-the-minority condition (i) was waivable by the special committee and (ii) only required approval by a majority of the minority shares voted (as opposed to a majority of all outstanding minority stockholders). Moreover, such protections must be "preconditions" to the transaction, not conditions that may be satisfied after the fact.[92]

While the majority-of-the-minority provisions were insufficient to entitle the defendants to the protection afforded by the business judgment rule, the Court suggested that they may have been sufficient to shift the burden of proof to the plaintiffs.[93] That determination – and the "modest procedural benefit" resulting from shifting the burden of proof[94] – could not be made at this stage of the action, however, given that certain of plaintiffs' disclosure allegations survived summary judgment.

V. *IN RE CNX GAS CORPORATION SHAREHOLDERS LITIGATION*

The preceding discussion of *Hammons* illustrates how the Delaware courts have wrestled with the effect that procedural safeguards employed by controlling shareholders should have on the underlying standards of judicial review for such transactions. While *Hammons* held that the proper use of both a special committee *and* majority-of-minority condition was necessary to secure business judgment review for the non-*Lynch* controlling shareholder transaction at issue, it also recognized the "recent suggestions of ways to 'harmonize' the standards applied to transactions that differ in form but have the effect of cashing out minority shareholders."[95] The doctrinal march toward the marginalization of *Lynch* continued in *In re CNX Gas Corporation Shareholders Litigation*,[96] which involved a two-step "*Siliconix*" transaction by a controlling shareholder seeking to acquire its subsidiary's outstanding shares via a first step tender offer to be followed by a short-form merger of the non-tendering shareholders. *CNX Gas* departed from the traditional deferential review accorded non-coercive and fully disclosed controlling shareholder tender offers in favor of a "uniform standard," similar to the one employed in *Hammons*, requiring both special committee negotiation and recommendation and a majority-of-the-minority shareholder approval condition. In so doing, *CNX Gas* goes further than *Hammons* in suggesting that a similar standard should apply to controlling shareholder squeeze-out mergers.

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91. *Id*. (citing In re PNB Holdings Co. S'holders Litig., 2006 WL 2403999, at *15 (Del. Ch. Aug. 18, 2006)).

92. The Court did not specifically address the propriety of the special committee, although it expressly rejected plaintiff's argument that the committee "was ineffective merely based on the fact that Hammons was able to veto any transaction." *Id*. at *14. That said, and as noted above, the Court apparently had questions concerning the independence of the special committee's advisors. *See supra* note 81.

93. *Hammons*, 2009 WL 3165613, at *14.

94. In re Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 617 (Del. Ch. 2005).

95. *Hammons*, 2009 WL 3165613, at *12 n.37 (citing *Cox Communications*, 879 A.2d at 606-07, 642-48; In re Cysive, Inc. S'holders Litig., 836 A.2d 531, 549 n.23 (Del. Ch. 2003); In re Pure Res. S'holders Litig., 808 A.2d 421, 443-46 (Del. Ch. 2002)); *see also supra* note 78 (addressing same).

96. 2010 WL 2291842 (Del. Ch. May 25, 2010).

CNX Gas involved a motion to enjoin preliminarily the nearly $1 billion tender offer by CONSOL Energy Inc. ("CONSOL") for the approximately 16.5% of the CNX Gas Corporation ("CNX") it did not already own. CONSOL, a leading producer of high-Btu bituminous coal and coalbed methane gas, controlled approximately 83.5% of CNX, a company created by CONSOL in 2005 to conduct its natural gas operations. CNX's remaining shares were held by institutional investors, the top 25 of which owned more than 14% of the company. In particular, T. Rowe Price Associates, Inc. ("T. Rowe Price") was the largest minority stockholder of CNX, owning 6.3% of CNX's outstanding common stock or roughly 37% of CNX's public float, as well as approximately 6.5% of CONSOL's outstanding stock and CONSOL debt.[97]

CONSOL's CEO (J. Bret Harvey), who became CNX's CEO and Chairman following a prior proposal by CONSOL to acquire the public shares of CNX that was received unfavorably by T. Rowe Price and other institutional investors, approached T. Rowe Price in September 2009 about its interest in exchanging its CNX shares for CONSOL stock. No further discussion progressed until T. Rowe Price met with executives of CONSOL and CNX on March 9, 2010, while attending an investor conference. T. Rowe Price's representatives floated a price in the mid-$40s at that meeting, and CONSOL indicated that a price of up to $40 could be acceptable.

On March 15, 2010, CONSOL announced its agreement to acquire the gas assets of Dominion Resources, Inc. ("Dominion") for approximately $3.475 billion (the "Dominion Transaction"). The announcement also identified the possibility of a CONSOL/CNX consolidation given that Dominion was a competitor of CNX. T. Rowe Price requested a meeting with CONSOL management the day after this announcement, and representatives of both companies met on March 19, 2010.

David Giroux, the head of the Capital Appreciation Fund, represented T. Rowe Price at that meeting. During the negotiation session, Mr. Giroux proposed a range of $42 to $50 per share for T. Rowe Price's CNX stock and rejected CONSOL's counteroffer of $35 per share as "'not realistic.'"[98] Mr. Giroux also rebuffed CONSOL's higher offer of $37 per share, communicating that T. Rowe Price needed $40 per share. That price was rejected by Mr. Harvey, who "regarded the negotiations as over."[99]

Mr. Giroux then left the meeting but returned with his "final offer" of $38.25 per share in cash after the others concluded a discussion of the Dominion Transaction.[100] Mr. Harvey agreed to the $38.25 per share price subject to CONSOL board approval, which occurred less than a week later. CONSOL and T. Rowe Price thereafter executed an agreement that obligated T. Rowe Price to tender (and not withdraw) its CNX stock upon CONSOL's tender offer at a price of no less than $38.25 per share in cash.

CONSOL commenced a tender offer on April 28, 2010 for the public shares of CNX at a price of $38.25 per share in cash.[101] The tender offer was subject to a non-waivable "majority-of-the-minority" condition excluding the CNX shares owned by directors or officers of CONSOL and CNX but including those held by T. Rowe Price. CONSOL also

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97. While T. Rowe Price's CNX holdings were held roughly evenly by its Capital Appreciation Fund (managed by David Giroux) and its Mid-Cap Growth Fund (managed by John Wakeman and Brian Berghuis), the Capital Appreciation Fund did not own any CONSOL stock or debt. *See id*. at *2.

98. *Id*. at *4.

99. *Id*.

100. The Court viewed the record as suggesting that Mr. Giroux had called Mr. Berghuis in the interim but acknowledged that the issue was undeveloped. *See id.* at *5.

101. The $38.25 tender offer price represented a premium of more than 45% over the closing price of CNX stock the day before the announcement of the Dominion Transaction and more than 24% over the closing price of CNX stock before the announcement of T. Rowe Price's tender agreement with CONSOL. *See id*.

committed to effect a prompt second-step short-form merger pursuant to Section 253 of the DGCL following successful completion of the transaction at the same $38.25 per share price.

CNX subsequently created a special committee comprised of CNX's sole independent director (John R. Pipski), which was vested with the power to review and evaluate – but not negotiate the terms of or consider alternatives to – the tender offer, prepare a schedule 14D-9 and retain legal and financial advisors.[102] The tender offer was not conditioned on an affirmative recommendation of the special committee and requests by Mr. Pipski to expand the committee by an additional director and broaden its authority were not granted.

While not authorized to negotiate, and notwithstanding Lazard's conclusion that the $38.25 per share price was "fair from a financial point of view" to CNX's minority shareholders, the special committee concluded that the $38.25 price may not have reflected the highest price CONSOL was willing to pay and sought a higher price. Although the special committee was later given retroactive authority to negotiate, CONSOL ultimately declined to increase the tender consideration and the committee "remain[ed] neutral" with respect to the tender offer in its Schedule 14D-9.[103]

The Court began its assessment of the motion by contrasting the differing standards of judicial review traditionally applied to controlling shareholder squeeze-out transactions based on the deal structure. While *Kahn v. Lynch Communications Systems, Inc*. mandated heightened "entire fairness" review for long-form mergers between a controlling shareholder and its subsidiary,[104] *In re Siliconix Inc. Shareholders Litigation*[105] and several subsequent Court of Chancery decisions[106] accorded deferential business judgment protection to non-coercive and fully disclosed controlling shareholder tender offers followed by a back-end short-form merger.[107]

Indeed, it was generally recognized after *Siliconix* that a controlling shareholder had no duty to offer the minority a particular – much less fair – price in connection with a non-coercive and fully disclosed tender offer.[108] Questioning

102. The special committee retained Skadden and Lazard as its respective legal and financial advisors. *See id.*

103. *See id.* (excerpting the special committee's Schedule 14D-9 disclosures).

104. *Lynch*, 638 A.2d at 1117; *see also supra* note 77 (addressing same).

105. 2001 WL 716787 (Del. Ch. June 19, 2001).

106. *See* In re Cox Radio, Inc. S'holders Litig., 2010 WL 1806616 (Del. Ch. May 6, 2010); In re Pure Res. S'holders Litig., 808 A.2d 421 (Del. Ch. 2002); In re Aquila Inc. S'holders Litig., 805 A.2d 184 (Del. Ch. 2002).

107. To be clear, and as recognized by the Court in *CNX Gas*, "the effectiveness of the *Siliconix* structure as a means of avoiding entire fairness review under *Lynch* depended on the absence of fairness review for the back-end short-form merger," which the Supreme Court decided one month after *Siliconix*, in *Glassman v. Unocal Exploration Corporation*, 777 A.2d 242 (Del. 2001). *CNX Gas*, 2010 WL 2291842, at *7 n.2; *see also Glassman*, 777 A.2d at 248 (holding that appraisal under section 262 of the DGCL is the exclusive remedy for minority shareholders challenging a short-form merger absent fraud or illegality and provided full disclosure). Together, *Siliconix* and *Glassman* provided controlling shareholders with a transactional blueprint for evading entire fairness review for going-private transactions notwithstanding that two-step *Siliconix/Glassman* transactions achieve the same ultimate outcome – and present at least the same risk of abuse – as one-step controlling shareholder squeeze-out mergers.

108. *See Siliconix*, 2001 WL 716787, at *6 (quoting In re Ocean Drilling & Exploration Co. S'holders Litig., 1991 WL 70028, at *3 (Del. Ch. Apr. 30, 1991)); *see also* In re Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 623 (Del. Ch. 2005) ("For years, there has existed a strand of Delaware law that stated that a controlling shareholder who made a tender offer – as opposed to a merger proposal – to acquire the rest of the controlled company's shares had no duty to offer a fair price."). The Delaware Supreme Court, quoting *Solomon v. Pathe Commc'ns Corp.*, 672 A.2d 35 (Del. 1996), recently recognized this principle as well. *See* Pfeffer v. Redstone, 965 A.2d 676, 684 (Del. 2009) ("'In the case of totally voluntary tender offers … courts do not impose any right of the shareholders to receive a particular price'" and "'in the absence of coercion or disclosure violations, the adequacy of the price in a voluntary tender offer cannot be an issue.'"). *Pfeffer* also quoted *Aquila* for the proposition that "'Delaware law does not impose a

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the "twin cornerstones" upon which those cases rested,[109] the Court in *CNX Gas* disagreed and in doing so framed the probative question as "[w]hat transactional structures result in the controlling shareholder not standing on both sides of a two-step freeze-out."[110]

The Court next turned to *Pure Resources*' enhanced requirements for rendering controlling shareholder tender offers "non-coercive" as a "move towards harmonizing the *Siliconix* and *Lynch* line of authority."[111] Specifically, *Pure Resources* held that such tender offers would only be deemed "non-coercive" – and thus free from fairness review – if (i) "'subject to a non-waivable majority of the minority tender condition,'" (ii) accompanied by a promise by "'the controlling stockholder … to consummate a prompt § 253 merger at the same price if it obtains more than 90% of the shares,'" and (iii) "'the controlling stockholder has made no retributive threats.'"[112]

Pure Resources nevertheless still questioned the wisdom of treating going-private transactions disparately based upon how they were structured, although the Court in that case advocated relaxing the *Lynch* element of the equation rather than rejecting the *Solomon/Siliconix* approach.[113] Those concerns were echoed in *Cox Communications*,[114] a decision resolving an attorneys' fee dispute, which *CNX Gas* characterized as "render[ing] the *Lynch* and *Siliconix* standards coherent by explaining that the business judgment rule should apply to any freeze-out transaction structured to mirror *both* elements

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duty of entire fairness on controlling shareholders making a non-coercive tender or exchange offer to acquire shares directly from the minority holders'" and stated that "Delaware law [does not] require entire fairness scrutiny where a corporation engage[s] in a voluntary, noncoercive [tender] offer." *Id*. (quoting In re Aquila Inc. S'holders Litig., 805 A.2d 184, 190 (Del. Ch. 2002)). Acknowledging *Pfeffer*'s "no right to a particular price" point, the Court in *CNX Gas* observed that *Pfeffer* did not involve a controlling stockholder squeeze-out transaction. *See CNX Gas*, 2010 WL 2291842, at *11 n.6. The Court also sought to distinguish the underlying *Solomon* decision, which similarly did not involve a squeeze-out, on its facts. *See infra* note 109.

109. Specifically, *CNX Gas* questioned both (i) the "statutory distinction between mergers and tender offers and the lack of any explicit role in the [DGCL] for a target board of directors responding to a tender offer" and (ii) the oft-cited statement by the Supreme Court of Delaware in *Solomon* "that a tender offeror has no duty to provide a fair price." *CNX Gas*, 2010 WL 2291842, at *8. With respect to the former, the Court relied on prior precedent and scholarly criticism in concluding that it failed to justify the differing standards of review. The Court also attempted to distinguish *Solomon*, wherein the Supreme Court stated "that '[i]n the case of a totally voluntary tender offer, as here, courts do not impose any right of the shareholders to receive a particular price,'" on the grounds that the tender offer in that case was part of an agreement negotiated by the controlling shareholder ("CLBN") "primarily in its role as a third-party lender" and thus involved "the case-specific reality that CLBN was not standing on both sides of the transaction." *Id*. at *11. In short, "[n]othing about CLBN's actions resembled those of a controller in a squeeze-out scenario" and the Court in *CNX Gas* concluded that *Solomon* "therefore does not hold that controllers never owe fiduciary duties when making tender offers." *Id*. at *9, *11.

110. *Id*. at *11.

111. *Id*.

112. Sensitive to "[t]he informational and timing advantages possessed by controlling shareholders," *Pure Resources* also held that "the majority shareholder target owes a duty to permit the independent directors on the target board both free rein and adequate time to react to the tender offer, by (at the very least) hiring their own advisors, providing the minority with a recommendation as to the advisability of the offer, and disclosing adequate information for the minority to make an informed judgment." *Pure Resources*, 808 A.2d at 445; *see also CNX Gas*, 2010 WL 2291842, at *12 (discussing same).

113. *See Pure Resources*, 808 A.2d at 444 ("To the extent that my decision to adhere to *Solomon* causes some discordance between the treatment of similar transactions to persist, that lack of harmony is better addressed in the *Lynch* line, by affording greater liability-immunizing effect to protective devices such as majority of minority approval conditions and special committee negotiation and approval.").

114. *See Cox Commc'ns*, 879 A.2d at 646 ("It was thought preferable in *Pure Resources* to keep the standards separate until there is an alteration in *Lynch* ….").

of an arms' length merger, *viz.* approval by disinterested directors *and* approval by disinterested stockholders."[115] Citing *Hammons*, the Court in *CNX Gas* further observed that "[d]octrinally, the use of both structural protections results in the controller standing only on one side of the transaction – as the buyer – and renders entire fairness inapplicable."[116]

CNX Gas consequently adopted the "unified approach" espoused in *Cox Communications*. Specifically, the Court held that because controlling shareholders do not enjoy "an inalienable right to usurp or restrict the authority of the subsidiary board of directors," business judgment review should only apply to two-step controlling shareholder going-private transactions if the tender offer was "both (i) negotiated and recommended by a special committee of independent directors and (ii) conditioned on the affirmative tender of a majority of the minority shares."[117] The special committee must moreover enjoy the requisite "authority comparable to what a board would possess in a third-party transaction."[118]

Applying this unified test, which it acknowledged diverged from *Siliconix* as modified by *Pure Resources*,[119] the Court held that plaintiffs had demonstrated a reasonable likelihood of success on the merits of their challenge to the tender offer. The special committee did not recommend the transaction – it remained neutral. Nor had the committee been authorized to negotiate or consider alternatives or deploy a rights plan against CONSOL.

The Court also noted "questions about the role of T. Rowe Price [which] undercut the effectiveness of the majority-of-the-minority tender condition."[120] In particular, T. Rowe Price's ownership of equity and debt in CONSOL raised questions as to whether it had "materially different incentives than a holder of CNX Gas common stock."[121] While

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115. *CNX Gas*, 2010 WL 2291842, at *12.

116. *See id*. *Hammons* acknowledged the "different standard [that] applies to transactions that effectively cash out minority shareholders through a tender offer followed by a short-form merger." *Hammons*, 2009 WL 3165613, at *10 n.21 (citing *Pure Resources*, 808 A.2d 421; In re Siliconix Inc. S'holders Litig., 2001 WL 716787 (Del. Ch. June 19, 2001); In re Aquila Inc. S'holders Litig., 805 A.2d 184 (Del. Ch. 2002)).

117. *CNX Gas*, 2010 WL 2291842, at *15. The Court noted its "depart[ure] from the language of *Cox Communications*" in expressly requiring an affirmative recommendation by the special committee in order for entire fairness not to apply. *See. id.* at *13.

118. *Id*. at *14.

119. *See id*. It similarly recognized that its adoption of the unified approach was incompatible with the recent decision by the Court of Chancery in *In re Cox Radio, Inc. Shareholders Litigation*, 2010 WL 1806616 (Del. Ch. May 6, 2010), which embraced *Pure Resources* as "provid[ing] the standard applicable … to tender offers made by controlling shareholders." *Id*. at *11. The *Cox Radio* decision, which involved the Court of Chancery's approval of a class settlement of alleged breaches of fiduciary duty in connection with a similar two-step freeze-out transaction by Cox Enterprises, Inc. for the remaining shares of its controlled subsidiary Cox Radio, Inc., was subsequently appealed to the Supreme Court of Delaware. Argument on that appeal is scheduled for November 17, 2010 as of the time of this Article.

120. *CNX Gas*, 2010 WL 2291842, at *16.

121. *Id*. The argument that T. Rowe Price should be treated like CNX's other minority shareholders given that its negotiator with CONSOL (Mr. Giroux) managed the Capital Appreciation Fund (which again held no CONSOL stock or debt) and viewed his duties as requiring him to obtain the highest price for T. Rowe Price's shares was found to be undercut by CONSOL's decisions to both enter into an agreement with T. Rowe Price for *all* of the CNX shares owned by T. Rowe Price and treat T. Rowe Price as a whole by including *all* of those shares in the majority-of-the-minority condition denominator. The Court also rejected the argument that an inquiry into the holdings of institutional holders would present an unworkable precedent given that CONSOL had chosen to enter into the tender agreement with T. Rowe Price and, thus, "T. Rowe Price's incentives [we]re at issue because of decisions that CONSOL and T. Rowe Price chose to make." *Id.* at *17.

the Court expressed an inclination to enjoin preliminarily the tender offer under *Pure Resources*, its evaluation of the transaction under the unified standard obviated its need to definitively rule on the effectiveness of the majority-of-minority condition.[122]

After dispatching plaintiffs' disclosure claims as "meritless,"[123] the Court turned to the irreparable harm and balancing of the equities factors which it concluded would weigh in favor of injunctive relief under *Pure Resources*. The application of the unified standard "simplifie[d] matters," however, since money damages could be awarded if defendants "fail to establish that the tender price [wa]s fair."[124] The Court thereafter conducted a traditional analysis and concluded that the availability of monetary relief post-trial militated against enjoining the all-cash premium transaction.[125]

VI. *BERGER V. PUBCO CORPORATION*

As noted in the preceding discussion of *CNX Gas*, the Supreme Court in *Glassman v. Unocal Exploration*[126] held that appraisal is the exclusive remedy for minority shareholders challenging a short-form merger absent fraud or illegality or inadequate disclosure.[127] With respect to the disclosure requirement in a short-form merger, *Glassman* mandated the disclosure of all facts material to the minority's decision whether to accept the merger price or seek appraisal.[128] What remained unclear, however, was the appropriate remedy for a controlling shareholder's breach of this disclosure obligation. The Supreme Court answered that question in *Berger v. Pubco Corporation*,[129] which acknowledged the quasi-appraisal remedy for the first time and held as a matter of law based on the facts before it that the contours of that remedy should apply to all minority shareholders automatically and that such shareholders are not required to escrow any portion of the merger proceeds paid to them.

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122. The Court made clear in a subsequent argument concerning plaintiffs' emergency motion for an injunction pending appeal that while it did not need to reach the issue in its opinion, it did not "think that [plaintiffs had] at this stage made the record necessary to get an injunction on the majority-of-the-minority condition because of … holes in the record." Transcript of Telephonic Oral Argument at 26, *In re CNX Gas Corp. S'holders Litig.* (Del. Ch. May 26, 2010).

123. *See CNX Gas*, 2010 WL 2291842, at *19.

124. *Id*. at *21.

125. The Court of Chancery subsequently granted an application by the CONSOL defendants to certify the *CNX Gas* opinion and order for interlocutory appeal to the Supreme Court of Delaware in a separate opinion that canvassed "[t]he current doctrinal bramble" resulting from the conflicting treatment of unilateral two-step going private transactions by controlling shareholders. *See* In re CNX Gas Corp. S'holders Litig., 2010 WL 2705147, at *3 (July 5, 2010); *see also id*. at *11 (emphasizing the prior lack of opportunity by the Supreme Court to address the *Siliconix*, *Pure Resources*, and *Cox Communications* decisions and the "real-world consequences" attendant to certainty concerning the underlying standard of review for such transactions). The Supreme Court nevertheless declined to grant an interlocutory appeal and ordered that the "issues raised in th[e] certification application should be addressed after the entry of a final order." In re CNX Gas Corp. S'holders Litig., 2010 WL 2690402, at *1 (Del. July 8, 2010).

126. 777 A.2d 242 (Del. 2001).

127. *See id*. at 248; *see also CNX Gas*, 2010 WL 2291842, at *7 n.2; *supra* note 107 (addressing same).

128. *See Glassman*, 777 A.2d at 248 ("Although fiduciaries are not required to establish entire fairness in a short-form merger, the duty of full disclosure remains…. Where the only choice for the minority shareholders is whether to accept merger consideration or seek appraisal, they must be given all the factual information that is material to that decision.").

129. 976 A.2d 132 (Del. 2009).

Pubco Corporation ("Pubco") was a privately-held Delaware corporation controlled by Robert H. Kanner, who owned over 90% of Pubco's shares and served as its president and sole director. Deciding to take Pubco private, Mr. Kanner transferred his Pubco shares to an acquisition vehicle[130] and effected a short-form merger that cashed out Pubco's minority shareholders, including plaintiff Barbara Berger, for $20 per share.

As noted by the Supreme Court, a parent's board of directors seeking to effect a short-form merger need only adopt a resolution approving the transaction and furnish the minority stockholders with a notice informing them of the merger's occurrence and their entitlement to seek a statutory appraisal.[131] "Section 253 requires that the notice include a copy of the appraisal statute, and Delaware case law requires the parent company to disclose in the notice of merger all information material to shareholders deciding whether or not to seek appraisal."[132]

Pubco disseminated the required notice of merger to its minority shareholders in November 2007 (the "Notice") informing them of the short-form merger and that they had been cashed out for $20 per share. The Notice further advised the minority shareholders of their right to seek an appraisal, attached an outdated version of the appraisal statute, provided general corporate information, and attached Pubco's unaudited, consolidated financial statements (which addressed all of Pubco's operations together). But the Notice contained no disclosure concerning how the $20 per share merger price had been determined.

Plaintiff brought a class action on behalf of all Pubco minority shareholders challenging the adequacy of the $20 per share merger consideration and the sufficiency of the disclosure. Plaintiff argued that the alleged disclosure violations entitled all minority shareholder class members to any increase over the $20 per share merger consideration regardless of whether the member had properly and timely demanded appraisal.

The Court of Chancery found that Mr. Kanner breached his duty of disclosure as Pubco's controlling shareholder in two respects. First, the Notice attached the wrong version of the appraisal statute in breach of the explicit requirements of section 253 of the DGCL. Next, the Notice failed to disclose the methodology by which the controlling shareholder unilaterally arrived at the $20 per share merger consideration. The Court found that this methodology was material to the minority's decision whether to accept the merger consideration or seek appraisal, particularly in the case of a private company like Pubco which "'made no public filings and whose Notice was relatively terse and short on details.'"[133]

Turning to the appropriate remedy, the Court of Chancery determined that the minority shareholders were entitled to a "quasi-appraisal" remedy with four features. First, the minority was entitled to supplemental disclosure of the material information not included in the Notice, including information concerning the methodology used to determine the merger consideration. Second, the minority should then be given the opportunity to participate in an action to determine the "fair

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130. As noted in *Pubco*, a short-form merger under section 253 of the DGCL is only available to corporate controlling shareholders, not individuals. *See id.* at 134 (quoting Delaware's appraisal statute and observing that "[t]he short form merger authorized by 8 Del. C. § 253 is available only where '… at least 90% of the outstanding shares of each class of the stock of a corporation … is owned by another corporation ….'").

131. *Id*. Specifically, section 262(b)(3) of Delaware's appraisal statute provides that "[i]n the event all of the stock of a subsidiary Delaware corporation party to a merger effected under § 253 … is not owned by the parent corporation immediately prior to the merger, appraisal rights shall be available for the shares of the subsidiary Delaware corporation." Del. Code. Ann. tit. 8, § 262(b)(3) (2010). The Court of Chancery's statutory duty in an appraisal proceeding is to determine the "fair value" of the company's shares, "exclusive of any element of value arising from the accomplishment or expectation of the merger." *Id*. § 262(h).

132. *Pubco*, 976 A.2d at 134.

133. *Id*. at 136.

value" of their shares regardless of whether they previously demanded appraisal. Third, minority shareholders choosing to participate in a fair value proceeding would be required to "opt-in" to the underlying action. Finally, minority shareholders opting-in would be required to place a portion of their short-form merger consideration in escrow.

Berger appealed, claiming that "all minority shareholders should have been treated as members of a class entitled to seek the quasi-appraisal recovery, without being burdened by any precondition or requirement that they opt-in or escrow any portion of the merger proceeds paid to them."[134] The Supreme Court agreed.

The Supreme Court first contrasted the "opt-in" requirement with that of an "opt-out" one that automatically treated the minority shareholders as members of the plaintiff class.[135] Whereas the forfeiture risk attendant to an "opt-in" remedy was burdensome to the minority, an opt-out structure eliminated any such risk. "To the corporation, however, neither alternative is more burdensome than the other" and "[u]nder either alternative the company will know at a relatively early stage which shareholders are (and are not) members of the class."[136] An opt-out structure was thus preferable.

The Supreme Court next addressed the propriety of an escrow requirement during the pendency of a quasi-appraisal proceeding. While acknowledging that minority shareholders would enjoy a "dual benefit" if permitted to retain the underlying short-form merger proceeds while simultaneously litigating to recover a higher amount, the Supreme Court did not view this as problematic or inequitable. Whereas the appraisal statute does not entitle minority shareholders to the merger consideration they would have otherwise received had they not sought an appraisal, shareholders in class actions challenging long-form mergers on fiduciary duty grounds may retain the merger proceedings while pursuing the class action remedy. The Supreme Court further grounded its rejection of an escrow requirement upon its conclusion that "[t]he appraisal statute should be construed even-handedly" as a matter of fairness:

> Minority shareholders who fail to observe the appraisal statute's technical requirements risk forfeiting their statutory entitlement to recover the fair value of their shares. In fairness, majority stockholders that deprive their minority shareholders of material information should forfeit their statutory right to retain the merger proceeds payable to shareholders who, if fully informed, would have elected appraisal.[137]

Because "the majority stockholder's duty of disclosure provides important protection for minority stockholders being cashed out in a short-form merger," the Supreme Court concluded that "the quasi-appraisal remedy for a violation of that … obligation … should not be restricted by opt-in or escrow requirements."[138] Importantly, however, the Supreme Court suggested that less expansive quasi-appraisal relief may be appropriate for technical disclosure violations, such as where stockholders receive an incomplete copy of the appraisal statute with their notice of merger.[139] The extent and contours of any such limitations remain to be developed.

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134. *Id*. at 138. Berger did not challenge the supplemental disclosure or standing requirements on appeal (*i.e.*, the first and second features above). *See id*.

135. In other words, the minority shareholders "would continue as members of the class, unless and until individual members opt-out after receiving the remedial disclosure and the Rule 23 notice of class action informing them of their opt-out right." *Id*. at 143.

136. *Id*.

137. *Id*. at 144.

138. *Id*. at 145.

139. *Id*.

VII. *MARIC CAPITAL MASTER FUND LTD. V. PLATO LEARNING, INC.*

The importance of full disclosure is not limited to short-form mergers. The Court of Chancery's decision in *Maric Capital Master Fund Ltd. v. PLATO Learning, Inc.*[140] revisits and highlights both the need for full disclosure in long-form mergers and the risk to corporate transactions absent such disclosure. While the standard for assessing the adequacy of disclosure remains unchanged, *Maric* provides valuable insights respecting the analysis of disclosure claims – not only for the particular areas of disclosure at issue, but also in other contexts in which disclosure deficiency claims commonly arise – and the potential risks presented by inadequate disclosure.

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Following the announcement by private equity firm Thomas Bravo, LLC ("Thomas Bravo") of its proposed acquisition of PLATO Learning, Inc. ("PLATO") for $5.60 per share, plaintiff Maric Capital Master Fund, Ltd. ("Maric"), a shareholder of Thomas Bravo, sought to enjoin preliminarily the transaction on two grounds: (1) the failure of PLATO's directors to secure the highest price attainable for shareholders under *Revlon*, and (2) the inadequacy of various disclosures in PLATO's proxy statement.[141]

At the conclusion of a hearing on plaintiff's preliminary injunction motion, the Court found that the plaintiff failed to establish a reasonable likelihood of success on its *Revlon* claim, but reserved judgment on the disclosure claims. In a written opinion issued later that day, the Court enjoined the transaction pending corrective disclosures with respect to three issues.[142]

Preparation of Fairness Opinion: The Court found the proxy statement materially misleading regarding the means by which PLATO's investment banker, Craig-Hallum Capital Group ("Craig-Hallum"), established the discount rate for the discounted cash flow ("DCF") analysis underlying its fairness opinion. The proxy statement suggested that the 23% to 27% range used by Craig-Hallum in its DCF analysis resulted from "an analysis of PLATO Learning's weighted average cost of capital."[143]

While "it [wa]s the literal case" that Craig-Hallum used a range of 23% to 27% in the DCF analysis presented to the special committee, that range did not result from the weighted average cost of capital analysis presented to the special committee.[144] Craig-Hallum presented two calculations of the weighted average cost of capital to the special committee

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140. 2010 WL 1931084 (Del. Ch. May 13, 2010).

141. *Id.* at *1. Although once viewed as a standalone duty, the duty of disclosure – otherwise known as the duty of candor – is now treated as subsumed within the hallmark duties of care and loyalty. *See*, *e.g.*, In re Transkaryotic Therapies, Inc., 954 A.2d 346, 357 (Del. Ch. 2008).

142. *Maric*, 2010 WL 1931084, at *1. Under well-settled precedent, the failure to make adequate disclosure in connection with a challenged transaction is sufficient to establish a threat of irreparably injury. *See id.* at n.2 (citing *Transkaryotic*, 954 A.2d at 346; In re Pure Res., Inc. S'holder Litig., 808 A.2d 421 (Del. Ch. 2002)); *see also* Wayne County Employees' Ret. Sys. v. Corti, 954 A.2d 319, 329 (Del. Ch. 2008) (recognizing that "[a] preliminary injunction motion is … the appropriate mechanism by which to challenge alleged disclosure violations" because the right to make informed decisions "if infringed, can only be truly remedied by a specific, injunctive order mandating the appropriate disclosure before the shareholders are required to vote").

143. *Maric*, 2010 WL 1931084, at *2.

144. *Id.* at *1.

(one based upon a capital asset pricing model and one based upon a comparable companies analysis), which resulted in discount rates of 22.6% and 22.5%, respectively.[145] While both discount rates presented to the special committee were "hefty," they were less than the lowest rate reflected in the proxy statement.[146]

During discovery, defendants provided several justifications for Craig-Hallum's use of this range. But these after-the-fact justifications were never suggested to the special committee.[147] Indeed, the only "*actual analysis*" generated by Craig-Hallum suggested a range of 22.5% to 22.6%, making the disclosure in the proxy statement materially misleading.[148] Nor was this a mere technical defect, as increasing the discount rate made the merger price "far more attractive" than it would have been under the discount rates suggested by Craig-Hallum's analysis.

Omission of Management's Free Cash Flow Estimates: The Court also found deficient defendants' "selective[]" and "inexplicable" omission of the free cash flow estimates provided to Craig-Hallum by PLATO's management.[149] To be sure, assuming compliance with federal securities laws, companies enjoy significant discretion regarding what to include in proxy statements. And the inclusion of too much information can itself be problematic.[150] The Court nevertheless concluded that the target "management's best estimate of the future cash flow of a corporation that is proposed to be sold in a cash merger is clearly material information."[151]

This is because shareholders voting on a merger must weigh the proposed merger consideration against the future benefits to be derived from the company if it does not merge. In this particular case, that required shareholders to determine whether it was worth "forsak[ing] the value that might obtain if the corporation remains independent" in exchange for "$5.60 for sure."[152] Because traditional corporate finance theory suggests that "the value of stock should be premised on the expected future cash flows of the corporation," future expected cash flows are a critical consideration. For this reason, the proxy statement "omit[ed] material information by, for reasons not adequately explained, selectively removing the free cash flow estimates from the projections."[153]

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145. *Id.*

146. *Id.*

147. To get from the rates reflected in the proxy statement, Craig-Hallum "heaped" "dubious," "eyebrow-raising premiums" "on top of" the rates suggested by the DCF analysis (including a "technology 'industry risk premium'" of 1.4% and a "small cap premium" of 9.5%). *Id.*

148. *Id.* The Court suggested that defendants may not have had to disclose how they determined the appropriate discount rates. But "[b]ecause the proxy statement spoke on this subject, [the directors had] a duty to do so in a non-misleading fashion." *Id.* at *2.

149. *Id.* at *1.

150. *Id.* (citing In re General Motors (Hughes) S'holder Litig., 2005 WL 1089021, at *13 (Del. Ch. May 4, 2005) ("Delaware law does not require 'directors to bury the shareholders in an avalanche of trivial information. Otherwise, shareholder solicitations would become so detailed and voluminous that they will no longer serve their purpose.'") (citation omitted)).

151. *Id.*

152. *Id.* (citing In re Netsmart Techs., Inc. S'holder Litig., 924 A.2d 171, 203 (Del. Ch. 2007) ("When stockholders must vote on a transaction in which they would receive cash for their shares, information regarding the financial attractiveness of the deal is of particular importance. This is because the stockholders must measure the relative attractiveness of retaining their shares versus receiving a cash payment, a calculus heavily dependent on the stockholders' assessment of the company's future cash flows.")).

153. *Id.*

Post-Merger Employment Negotiations: The proxy statement also disclosed that one factor in the decision of the special committee and the board of directors to approve the merger was "'the fact that Thomas Bravo did not negotiate terms of employment … with [PLATO's] management for the period after the merger closes.'"[154] But whether formal "negotiations" or not, the "reality" was that PLATO's CEO engaged in "extended discussions" with Thomas Bravo concerning "the typical equity incentive package given by Thomas Bravo to management" in other deals, which "typically consist[ed] of 10% of the common stock, with 4% going to the CEO."[155] Moreover, in these "extended discussions," PLATO's CEO asked if Thomas Bravo preferred to retain management, was assured that it typically did, and was led to believe that "top management would likely be retained" if the transaction was consummated.[156]

As it did in its discussion regarding the DCF analysis, the Court emphasized the importance of full disclosure once a company elects to speak on a topic. Although the Court had little doubt that management would have "rationally believed" that a private equity buyer like Thomas Bravo would provide such incentives to incumbent management, the disclosure concerning the CEO's negotiations concerning post-transaction employment "create[d] the materially misleading impression that management was given no expectation regarding the treatment they could receive from Thomas Bravo."[157] The Court therefore ordered corrective disclosures to "clarify the extent of actual discussions" between Thomas Bravo and the incumbent CEO.[158]

VIII. CONCLUSION

The decisions summarized above reaffirm Delaware's commitment to the director-primacy model. *Hammons* and *CNX* stress the important role played by boards of directors as a bastion against interference by controlling shareholders. The substantial deference afforded to unconflicted boards in *Selectica* and *Citigroup*, as well as *Lyondell*'s holding that independent and disinterested directors essentially enjoy free rein in the *Revlon* context, underscore this tenet. The limited disclosure remedies granted in *Berger* and *Maric* are consistent with this board-centric paradigm as well.

To the extent that the Delaware courts have scrutinized the actions undertaken (or, in the case of *Citigroup*, forgone) by directors, their decisions reveal the judiciary's sensitivity to circumstances that call into question the foundations of the business judgment rule. In this sense, the decisions embody the highly contextual approach undertaken by the Delaware courts. While boards of directors and their counsel must therefore continue to pay careful attention to all attendant facts, they may take comfort in the continuing stability of Delaware's preeminent corporate law.

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154. *Id.*

155. *Id.*

156. *Id.*

157. *Id.*

158. *Id.*