PANEL: THE EVOLUTION OF M&A LITIGATION IN THE CHANDLER ERA†

PROFESSOR RONALD J. GILSON[1]: This is an opportunity that most academics do not get, which is the chance, not only to talk to each other, but also to talk to serious practitioners and then also to talk to judges. And that last point—that in the room is the chancery court—adds something at least a little odd to the presentations. So, what comes to mind: many of you will remember a movie called *Annie Hall*[2] and there is a wonderful scene in which Woody Allen and Diane Keaton are waiting in line to see a movie, and there is a couple behind them, and the gentleman is going on and on about Marshall McLuhan[3] in a pompous, condescending way. And Woody Allen loses his temper and berates the man and, uncomfortably, the man turns to Woody Allen and says, "I'm a professor at Columbia. I know all about this stuff!" At which point Marshall McLuhan—the real person—walks up and berates the guy. So, for all of us who are going to be talking about what the opinions mean, this is a magical moment, for the people who really did it are here in the room and it imposes a little bit of discipline.

The panel is going to talk about Delaware's takeover jurisprudence. Given that there are two serious practitioners on the panel, what I wanted to do is take a step back and try to look at the trajectory of Delaware takeover law through the prism of two facts. The first is what might be a long-standing tension between the chancery court and

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[2] ANNIE HALL (Metro Goldwyn Mayer 1977).

[3] Herbert Marshall McLuhan (1911–1980), philosopher, writer, and media analyst. *See, e.g.*, HERBERT MARSHALL MCLUHAN, UNDERSTANDING MEDIA (1964).

the Delaware Supreme Court. The Supreme Court announces a relatively vague rule, the chancery court spends a number of years trying to operationalize it, and then the Supreme Court decides to change the rule. I want to discuss that in connection with a second characteristic. As we all know, the chancery court is one of equity, and I suggest that the Supreme Court ends up being, in effect, a court of law, and tension between the two courts reflects the merger of law and equity, in effect, in Delaware.

In 1985, the Supreme Court decides *Unocal*.[4] We get a two-level test. Is there a threat? Is it proportional? We read the opinion; we do not have a clue about what any of it means. For the next five years, the chancery court begins to work through those tests, generating at least an understandable, coherent way to approach it.

Then we come to *Time-Warner*,[5] and the quote there is one of my favorites: "to the extent that the court of chancery

[4] *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). In *Unocal*, minority shareholder Mesa made a two-tier, "front-loaded" cash tender offer for 37% of Unocal's shares. *Id.* at 949. The Unocal board believed that Mesa's offer significantly undervalued Unocal shares and launched a self-tender offer at a higher price. (Mesa was excluded from the tender offer.) *Id.* at 950–51. In vacating the Chancery Court's grant of a preliminary injunction against the Unocal self-tender, the Delaware Supreme Court famously announced a two-part test for determining whether a board's defensive actions in the face of a hostile tender offer will come within the ambit of the business judgment rule. First, the board, must have "reasonable grounds for believing that a danger to corporate policy and effectiveness exist[s]" if the hostile bid is successful. *Id.* at 955 (citing Cheff v. Mathes, 199 A.2d 548, 554–55 (Del. 1964). Second, the defensive measure must be "reasonable in relation to the threat posed." *Id.*

[5] *See* Paramount Commc'ns, Inc. v. Time, Inc. (*Time-Warner*), 571 A.2d 1140 (Del. 1989). The Time board adopted defensive measures to block a hostile tender offer from Paramount so that Time could proceed with its long-planned merger with Warner Communications, Inc.. *Id.* at 1146–49. Although the agreement with Warner valued Time's shares at $175 while Paramount had offered $200 per share, the Time board's "prevailing belief was that Paramount's bid posed a threat to Time's control of its own destiny and retention of the 'Time Culture.'" *Id.* Paramount filed for a preliminary injunction, arguing that Time's board had breached its obligations under *Unocal*. *Id.* at 1142. The Delaware

has recently substituted its judgment for the Board, *Interco* and its progeny are rejected."[6] Of course, *Interco*[7] did not do anything like that; it was a fight between shareholders and directors. The chancery was not doing much of anything.

We move ahead to *Unitrin*,[8] and we begin to see a preference toward elections, away from market control transfers. Appeal is not preclusive if you can run an election. And the Supreme Court reverses the chancery court on whether the interference with the electoral process is sufficient to warrant judicial intervention.

Supreme Court held that Time was reasonable in perceiving Paramount's offer as a threat, rejecting Paramount's argument that a tender offer is only a threat when the target's shares are inadequately valued. *Id.*

[6] *Id.* at 1153.

[7] *See* City Capital Assocs. Ltd. P'ship v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988), *appeal dismissed as moot*, 556 A.2d 1070 (Del. 1988). Interco had implemented a shareholder rights plan, or "poison pill," to block a tender offer from Cardinal Acquisition Corp. so that the Interco board could continue its plan to restructure the company. *Id.* at 789–90. The price of the tender offer was only slightly less than the estimated value that shareholders would have received under the board's restructuring plan. *Id.* at 799. The chancery court found that the tender offer did not constitute a "threat," under the first prong of the *Unocal* test, sufficient to justify the adoption of the poison pill. *Id.*

[8] *See* Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995). American General announced a plan to merge with Unitrin by purchasing $2.6 billion of Unitrin shares at $50 per share. *Id.* at 1370. Believing this offer undervalued the company, the Unitrin board adopted a poison pill. The board also announced a share repurchase program, which would have reduced the company's outstanding shares and potentially increased the percentage held by board members to a level that would allow them to block any merger. *Id.* at 1370, 1378–79. The Delaware Supreme Court held that in applying enhanced scrutiny under *Unocal*, the chancery court was first required to determine whether the board's defensive measures were "draconian" by being either "preclusive or coercive." The Supreme Court found that the poison pill and the share repurchase were not coercive and that repurchase program was not necessarily preclusive, although each measure made a takeover more difficult. However, the Supreme Court remanded the case to the court of chancery to determine whether the Unitrin board's actions "individually and collectively" were within the range of defensive measures that would be reasonable and proportionate under the second *Unocal* prong. *Id.* at 1390.

I want to end this sequence with *Airgas*.[9] Chancellor Chandler describes the chancery court's view, or at least the view of a number of Vice Chancellors that he cites, that in terms of chancery court's preference, it remains where it was twenty years ago.[10] But the Supreme Court is still going the direction it goes. Predictably then, after *Time-Warner* and after *Unitrin*, the action moves into the proxy area. What we are left with, as it is presented in *Airgas*, is the question of whether success of a tender in the proxy contest is "realistically attainable."[11] We are not at a point of mathematical possibility or hypothetically conceivable, but "realistically attainable," pulling language from the Supreme Court.

Thinking of the trajectory, the sense of the area at that point, reminds me very much of where we were immediately after *Unocal*. "Realistically attainable" turns out to be, in fact, a fairly accordion-like framework. A number of things happened. One is the potential for rigging elections. What is predictable that will happen is many of the practitioners in the room, responding to the needs of their clients, will push

[9] *See* Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48 (Del. Ch. 2011). In *Airgas*, Air Products made several hostile offers for Airgas, the last of which valued the company at $70 per share. *Id.* at 55. The Airgas board maintained that the company was worth at least $78 per share and kept in place a number of defensive measures, including both a staggered board and a poison pill, during a year-long battle for control of the company. *Id.* at 55–56. The chancery court upheld the Airgas defensive measures based on Delaware Supreme Court precedent that the combination of a staggered board and poison pill are note preclusive. *See id.* at 181–82 (citing Versata Enters. v. Selectica, Inc., 5 A.3d 586, 604 (Del. 2010)).

[10] *See Airgas*, 16 A.3d at 56–57 ("Although I have a hard time believing that inadequate price alone (according to the target's board) in the context of a nondiscriminatory, all-cash, all-shares, fully financed offer poses any 'threat'—particularly given the wealth of information available to Airgas's stockholders at this point in time—under existing Delaware law, it apparently does. . . . Trial judges are not free to ignore or rewrite appellate court decisions. Thus . . . I am constrained by Delaware Supreme Court precedent to conclude that defendants have met their burden . . . .").

[11] *See id.* at 114–16.

that envelope as far as they can in each case. Legitimacy, as it was raised by then Chancellor Allen in *Blasius*,[12] is increasingly an issue—an interesting issue in our capital markets.

Now frame a simple question: the target board decides to take a set of actions. Our proxy experts decide these actions increase the likelihood that the board will win by ten percent, or fifteen percent, or twenty percent. What do you make of that in the context of "realistically attainable?" It may be a point estimate, but otherwise, what you are asking is how much rigging do we allow the board to do in the context of what in the end, as Chancellor Allen said, is the "only legitimizing feature?"[13] So the chancery court inevitably is going to deal with the issue in a series of cases. They are going to have to figure out a way to operationalize the "realistically attainable" language because the cases keep coming. And then the issue will go to the Supreme Court.

What might account for the persistence of the tension between law and equity? It is interesting that the *Airgas*

[12] *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988). Blasius had a 9% stake in Atlas when it submitted a precatory resolution calling for the board to raise debt in order to distribute cash to shareholders and sought to add eight members to the board, which would have provided Blasius with a majority. *Id.* at 653–54. The Atlas board amended the company's bylaws to increase the size of the board by two and filled the newly-created seats with Atlas-friendly directors to prevent Blasius from obtaining a board majority. *Id.* at 654–55. The chancery court held that defensive measures taken for the primary purpose of interfering with the proxy process, even when made in good faith pursuit of a corporation's best interests, so obstruct shareholder franchise as to lose the protection of the business judgment rule. *Id.* at 659–60. The court also held that a board bears the burden to present a "compelling justification" for defensive measures that interfere with the shareholder franchise. *Id.* at 661, 662–63.

[13] *See id.* at 659 ("The shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests."). Chancellor Allen's conclusion in *Blasius* was based on the notion that the shareholder mandate is the source of a board's authority, and that directors' interference with the shareholder vote thus violates their duty of loyalty as the shareholders' agents. *Id.*

opinion essentially echoes a position that the chancery court had taken twenty years ago and was plainly rejected over and over again by the Supreme Court.[14]

Here is at least a thought about it. The traditional focus of equity was resolving a dispute between the parties. Historically, it was based equally on the facts and typically, certainly in the English period, without any concern about precedent at all. The law courts, in contrast, cared little about the case in front of them. Their job was policing the rules.

The style of an equity court is something that we have all become fairly familiar with. A typical chancery court decision begins with a very lengthy account of the facts: twenty, thirty pages of detail—who talked to whom, who did what? Often my students hate it, and I never edit the facts because it is the best way to teach students about what is actually going on in these transactions. So the result is the issue of fairness, the application of a standard in a particular case is resolved in a deeply contextual way. The judges know the industry, and they know the case. From an academic's point of view, the biggest danger of ex post litigation is that the judge will make a mistake. The more facts the judge has and the more experience the judge has, the less risk there is, and hence, the less reason to bring the litigation in the first place.

What follows from attention to the contextual background is that, for a lawyer, the Delaware Chancery Court is a remarkable resource. For those of you who remember commercial law, Carl Llewellyn said that disputes between merchants ought not to be resolved by juries or even by general judges,[15] they ought to be resolved by specialized tribunals—in Llewellyn's term, "merchant juries."[16] This

[14] *See supra* note 7.

[15] *See, e.g.*, Zipporah Batshaw Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant Rules*, 100 HARV. L. REV. 465, 526–27 (1987) (describing Llewellyn's attempts to provide for a system of merchant juries in light of the concern on the part of the Merchants' Association that lay jurors would be unable to represent their interests).

[16] *Id.*

concept did not get into the Uniform Commercial Code, but it got into Delaware. That is, major commercial disputes are resolved in Delaware by expert judges who see transactions over and over again, who understand the context and are much less likely to make a mistake. The absence of uncertainty is an enormous advantage.

There is a different characterization of the Supreme Court. I mean this not as a criticism, but rather as a nod to the different role it serves. You begin to see, not the contextual inquiry that the chancery court makes, but rather a concern with the shaping of the standard. Basically, you end up with two competing systems with very different functions. The Supreme Court announces rules and standards, the chancery court operationalizes them. It has been suggested that this operationalization provides the attraction of the Delaware jurisdiction.

Why is this important? What you begin to see, at least what I see after reading lots of cases—and I am waiting for Marshall McLuhan to walk up behind me—is a pattern. Within the chancery court, the facts are driving the outcome. The *standard* may shape it—shape it roughly—but what is going on in *that case*, a sense of fairness of the process in that case, drives the outcome. So, from the *Interco* and *Airgas* cases, I get a sense that the chancery court feels that when the board has a chance to do everything it can, and when the shareholders understand the argument, then the shareholders get to decide.[17] Now that is not always true. There is a set, even within the chancery court, of circumstances—I think of *Apple Bancorp*[18] as the best

[17] *See* City Capital Assocs. Ltd. P'ship v. Interco Inc., 551 A.2d 787, 799–800 (Del. Ch. 1988), *appeal dismissed as moot*, 556 A.2d 1070 (Del. 1988); Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 106 (Del. Ch. 2011).

[18] Stahl v. Apple Bancorp, Inc., 579 A.2d 1115 (Del. Ch. 1990). In *Apple Bancorp*, Stahl, a majority shareholder, announced plans to wage a proxy contest for the election of directors and made a public tender offer for the remaining shares of Apple Bancorp stock. *Id.* at 1117. Before the date was set for the election of directors or any proxies had been solicited, the board responded by announcing that it was deferring the annual meeting to explore alternative transactions, given its advisors' advice that

example—that nonetheless require and receive a different outcome.

Think of the following example: there is a claim of substantive coercion; that is, there is a claim that the shareholders will be misled. I suggest to you that when you read the cases, what you will see is not a fact to be found but a rebuttable presumption to be applied. If one had the facts that are described in Chancellor Chandler's opinion in *Airgas*, you have testimony from both sides; there are no more facts to tell anybody.[19] These are sophisticated shareholders. They can understand it. If there is substantive coercion, it is simply a presumption of the authority of the board rather than a fact to be found.

So what is going on? The one thing I want to be clear about is we are not talking about a "race to the bottom, a race to the top" notion. What I perceive flowing through the Supreme Court's jurisdiction is a realistic concern about what public policy ought to be in this area.

What is left of the takeover game, in my view, is largely a battle over the "installed base" of the American economy; not new companies, but the existing large companies for whom the poison pill and pre-existing staggered boards are essentially the only potentially effective defenses. Those who come to our circumstances with a fundamentally Burkeian approach, believing that change should come slowly, should be concerned about uncertain consequences. The board plays essentially the same role as Burke's celebrated monarchy, aristocracy, and clergy. We embed in serious, responsible,

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a higher value could be obtained. *Id.* The chancery court held that under these circumstances, the board's response did not constitute the type of obstruction of the shareholder franchise that it had found in *Blasius*, and thus did not require the board to demonstrate a "compelling justification." *Id.* at 1122–23. Instead, the court applied *Unocal* and determined that the board reasonably found that the combination of the proxy contest and the tender offer constituted a threat, and that the board's response was reasonable and proportionate. *Id.* at 1124–25.

[19] *See Airgas*, 16 A.3d at 106 ("Airgas's directors and Airgas's financial advisors concede that the Airgas stockholder base is sophisticated and well-informed, and that they have all the information necessary to decide whether to tender into Air Products' offer.").

disciplined people the ability to slow things down. And for people with Burke's view, slowing things down is a fundamentally good thing. The other side of that, of course, is Schumpeter. For Schumpeter, growth comes—innovation comes—from creative destruction, from shaking up the base. These are two different ways of viewing the world.[20]

The interesting thing for policy—I suppose for the courts, but just as much for everyone else, and I will leave you with this—is that this large public policy issue, which gets draped in doctrinal rhetoric, becomes critical. Old jobs are not coming back. Companies have learned to run things far more leanly and more efficiently. So, if we are going to see growth, if we are going to see employment growth, it is going to come from innovation. And then the question becomes: how do you energize the base? Do we observe innovation coming from outside? How do we cause—the business term is the "installed base"—to be "ambidextrous," so that they can do their own business and also innovate, but in ways that will not cannibalize the doing of their own business.

I do not think this is resolvable in corporate law terms. The chancery court is addressing internal issues—that is they are addressing individual cases in front of them, resolving those cases deeply in context. For me, the best way to make sense out of the Supreme Court is that, in the end, it is addressing external issues. That is, the commitment to board discretion, often without regard to the facts, is a commitment to the way one governs, to whom we allocate authority in this economy. And that is a perfectly defensible position. But the difference between those thoughts is going to create the tension and motivate their internal dialogue.

Where do we end up? The first prediction, with an awful lot of variance, is that we are going to end up seeing, over time, the same kind of tension over "realistically attainable" and the extent to which the board can alter the balance within proxy contests as we saw with *Unocal*'s threat and

[20] *See generally*, Ronald J. Gilson & Reinier Kraakman, *Takeovers in the Boardroom: Burke versus Schumpeter* (Columbia Law Sch. Ctr. for Law and Econ. Research Paper Series, Working Paper No. 280, 2005), *available at* http://papers.ssrn.com/ sol3/papers.cfm?abstract_id=732783.

proportional language. The second prediction is that over time, the chancery court will treat "reasonably attainable" in the context of particular cases, which will cause boards to get slapped down. And in the end, the Supreme Court will come back and narrow the scope.

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WILLIAM SAVITT[21]: I would like to make a few observations that I think are non-controversial, in regard to present practice in the court of chancery as it relates to shareholder litigation in mergers and acquisitions. And then I would like to situate those observations in a broader context, practical and theoretical, that points out the significance—and, I think it can even be said, the genius—of what the court of chancery has achieved, which is to ensure that its teachings, that its doctrine, will be in the boardroom, in every public company merger or acquisition that is negotiated in the United States.

Here are a handful of simple observations, again, I think non-controversial. The first is that the incidence of class action shareholder litigation challenging public company deals has sky-rocketed in the past ten years. Research, going back to the 1999–2000 period says that about 12% of announced deals drew litigation, challenging them on the basis of fiduciary duties and related sorts of claims. By 2005, 39% of deals drew such litigation. By 2010, 84% drew such litigation, and I should say that the most recent data is drawn from a paper as yet unpublished by my colleague on the panel, Professor Stephen Davidoff, that I think is going to be a very important contribution to what is happening empirically in M&A litigation.

I think it can be said that, even from an anecdotal perspective, 84% seems a little low, and it shows no sign of slowing. While I appreciate that not all of that litigation is in Delaware, there is no doubting that there is a remarkable

[21] Member, Wachtell, Lipton, Rosen & Katz. Lecturer-in-Law, Columbia University School of Law.

fraction of deals that find themselves litigated one way or another in the court of chancery. So while ten years ago, fifteen years ago, it was an outlier transaction that would draw litigation; now it is an outlier deal that does not draw litigation. And this is a point that really is worth lingering over. If I had time, I would linger—I do not.

But I will say that it is really spectacular growth, to go from a situation where one in ten deals draws litigation to nine in ten deals drawing litigation. It reflects the emergence of a new industry, of a new mindset, of a new level of scrutiny that each transaction that is done is going to be subject to litigation in the court of chancery. We have gone from zero to ubiquity in the past ten years in terms of litigation challenging public company deals. And by that I do not mean that it was zero; I mean it was quite unusual in third-party premium merger transactions—very, very tough to find any litigation fifteen years ago challenging it. Now, it follows as night from day.

Second fact: not only are a lot more deal cases being filed, they are being litigated more intensively, more energetically, more deeply, and almost certainly after much more discovery. Among other things, this appears to be a function of better capitalized, more aggressive, more professionalized plaintiffs' attorneys, who are responding to legal rules and fee incentives and have created a basis for deeper litigation challenges in the many, many cases that are filed.

It needs to be conceded that many cases are settled. There are many cases settled very early on in the process, but the folks who settle cases and the plaintiffs who sponsor such lawsuits are all on firm notice that settlements will be scrutinized with care in the court of chancery. So, even in that context, there is much more deep digging going on. There is not so much just kicking the tires; there is opening the hood, there is a lot of elbow grease. I could mix my metaphors, but I will not. The point is there is a lot more litigation, and it is happening more deeply.

The third piece of information that I think is not controversial is that there is just—let me put it this way, chancery court decisions are long. [*Audience Laughter*]

They are—they are long. Really, it is a relative term. You know, they are just long, they are long compared to anything. They are long compared with other trial court decisions. They are long compared with Supreme Court decisions. They are long. They are long. Fifty, seventy, eighty, a hundred, a hundred and twenty, a hundred and fifty pages—they are long. And you see the pages flipping. [*Audience Laughter*]

And that is not the only authority that is being generated out of chancery. There are transcripts. And the transcripts are a tremendous source of learning and knowledge about what is going on in the chancery court, what is on the minds of the Chancellor and Vice Chancellors. And while I understand that fifteen years ago, these were largely private transcript rulings—that the whole world did not have them—now, to paraphrase Mark Twain, the transcripts are around the blogosphere before the published opinion has put on its shoes.

There is a vast amount of legal authority and I understand from some of my senior partners that in the days of Chancellor Brown, the decisions were two, three, four pages long. You just do not see it anymore. There is much more legal knowledge—legal authority—out there.

So, the next point I wanted to make, and here again I think and hope not controversial, is that cases challenging mergers are class actions—they are almost exclusively class actions. One of the results of that is that we have had the development of a very well-defined group of highly effective class action merger lawyers. And because they operate in the class context, their work is overseen in every case by the court. In some cases, they are actually *selected* by the court. Stepping back, what you really have is that there exists now a group of people whose lives are dedicated to finding fiduciary breaches and doing everything in their power to show them up.

This is a new phenomenon, and there are experts in the business of finding fiduciary breaches, and they are overseen by a still more expert chancery bench that, of course, has to resolve the claims that are made. This professionalized

cadre of fiduciary duty lawyers is bringing their cases to the court, who sees each of them presented professionally. And even when they are settled, there is no rubber stamp. The point, here again, is that there is an enormous amount of law and legal review that did not exist even ten years ago.

And that brings me to my final and I think least controversial of non-controversial propositions, which is, you have in Delaware a truly *expert* bench. The judges of the chancery court are appointed by virtue of their expertise. They become expert by virtue of the pitiless succession of fiduciary duty cases that come before their docket. There is a deep and continuous exposure to a very specific kind of work, and the judges of the court are forced to—and do—expound on and interpret, at length daily, the world of fiduciary duties that is at issue in the cases that we have been talking about. And I say that recognizing that the chancery's portfolio is not limited to merger cases—the equitable brief is larger than that. But I do not think there would be any dispute to the proposition that you have a truly expert group of judges.

Now, taken individually, none of these points really are particularly controversial. But the point I wanted to make is that they add up to something truly unique: that chancery court is a common law court. In a sense, it is as old school a common law court as there can be—it is a court of equity. But, it is an exceptional court because it can also be described this way: as a governmental entity that is staffed by experts and assisted by a cadre of enforcement attorneys, armed with substantial ruling and adjudicating authority over the conduct and disclosure of transactions within its substantial jurisdictional compass, charged with using that authority to regulate a broad field of economic conduct.

Described that way, it represents a regulatory authority. And in reaching that conclusion, I do want to emphasize that chancery sees and has the power to regulate a vast amount of M&A activity—and that is what it does. Its field of vision, in this sense, is more like a regulator than a court. It is not episodic. It is not random. It is constant. It is not complete, but it is substantially representative. So you are dealing

with a court that sees the entire field. The chancery court is not prisoner to the arguments that are presented. It has, and it uses, the power to frame the issues that are presented to it for disposition. And accordingly, and in these ways, it operates as a very special kind of common law court.

There are few conclusions that flow from this—a couple of points that I put under the rubric and phrase of dictum. I clerked for a couple of judges who had signs up saying, "No dictum!" It was like the "No whining!" signs I have in my kid's room. "No dictum!" "No dictum!" I think dictum has a place, and I think it is used to enormously powerful effect by the court of chancery. It is a court that has at its disposal a choice of policymaking forms. It can make rules the old-fashioned, common-law way, which is by narrowly deciding the cases in front of it—and to be sure, it does that. It does it often. But chancery is not shy about announcing new rules in dictum, rules that are intended to, and plainly do, lay down new rules of the road about how parties might structure transactions. And for a very good example among many, I would point to Chancellor Chandler's *John Q. Hammons*[22] decision, which set out some very helpful rules for practitioners about how to deal with certain sorts of controlling shareholder transactions. At the same time, it was announcing a rule that really was not necessary for the disposition of the case.

[22] *See In re* John Q. Hammons Hotels Inc. S'holder Litig., C.A. No. 758-CC, 2009 WL 3165613 (Del. Ch. Oct. 2, 2009). In *John Q. Hammons*, the company's board had approved a merger in which the controlling shareholder and minority shareholders would receive different merger consideration. The chancery court held that the "entire fairness" standard of review applied to the board's actions because of procedural deficiencies in the approval of the transaction. *Id.* at *13. However, the Court also noted that the business judgment rule would normally apply if "there [are] robust procedural protections in place to ensure that the minority stockholders have sufficient bargaining power and the ability to make an informed choice . . . ." *Id.* at *12. The desired procedural protections were recommendation of the plan of merger by an independent special committee and approval of the of the merger plan by a majority vote of minority shareholders. *Id.*

It is in the sense that that dictum points the way forward that I would say that it merits praise. And it is important because it allows the rules of chancery to, in many cases, not be applied retroactively, but to be applied prospectively, avoiding the kinds of criticisms of the retroactive application of new rules that have been leveled at the common law system by Judge Friendly going back some number of years.

Look, people criticize dictum on the theory that the judge does not really know what is going on, that the judge should not speak about matters that are not clearly within the Court's field of vision. I do want to emphasize that this is no ordinary dictum. It is considered dictum, and it is dictum by a court with, as I was saying, this very large field of vision in front of it. And I think that is what makes chancery such an extraordinary institution and the broad canvas so important to the continuing function of this aspect of the court.

To expand the analogy a little bit farther, I think it can even be said that the court has something like the benefit of a "notice and comment" procedure, provided by its frequent participation in programs like this and bigger ones and smaller ones and classes and publications that happen throughout the country, indeed, throughout the world, where the judges of the court are in touch with practitioners, are in touch with scholars, are acting in an interactive way with the blogosphere and the academics.

Chancellor Chandler made very much the same point at Penn Law School, not long ago, when he noted that the chancery court acts in real time; it effectively engages in a dialogue, not just with the litigants before it, but also with academics, practitioners, and writers. And this adds further ballast, further legitimacy to the expansive function of rule-setting and adjudication that, I am arguing, marks the genius of the "Chancery System."

So, there are three conclusions that I wanted to touch on briefly that flow from the foregoing. The first is to point out that chancery permits regulation of a broad field of conduct and in general, often it permits regulation prospectively rather than retroactively. And in that sense, it solves for one of the principal arguments that have frequently, and I think

persuasively, been made against the common law as a rule-making system.

A second area relates to what Frederick Schauer, in a very influential 2006 article, called the "availability heuristic."[23] The article—and I recommend it to all of you—really amounts to a critique of the common law system *simpliciter*. And the idea is that in ideal circumstances, the judge creating a rule would do so on the basis of an accurate, or at least an expert, assessment of the full set of future circumstances to which the rule would be applied. But in fact, Schauer argues that decision makers generally—and particularly common law judges, who by virtue of their job, in most instances are generalists rather than specialists—are confronted with an episodic example of a specific problem, or in his words, "are mesmerized by the case in front of them."[24] And they too often announce a rule, he argued, that works best, or works only at all, if the instant case is representative of the broad range of cases, which of course, it seldom is, statistics being what they are.

The chancery court largely solves for the availability heuristic. Schauer has not yet said that they have solved for it, but that is the argument here. I mean, here you have only five judges on this court, who see a broad universe of cases. The cases are nearly all presented professionally and, in some sense, on the merits, in the full view of the court. The court is not captive to a unique fact pattern. It is unusual among common law courts—though, in some sense, it is like a regulator—in having the entire industry, the entire problem set, the broad perspective of that expertise in front

[23] *See* Frederick Schauer, *Do Cases Make Bad Law?*, 73 U. CHI. L. REV. 883 (2006). Schauer describes the "availability heuristic" as "[the] phenomenon of being overinfluenced by proximate examples." *Id.* at 894–95. Schauer uses the availability heuristic phenomenon to argue that "ordinary cases impress their facts on the judges who have to decide them, and scarcely less than great cases or hard cases appear to demand proper resolution purely by virtue of their very presence in the foreground of judicial phenomenology. To the extent that this is so, then it is not just great cases and hard cases that make bad law, but simply the deciding of cases that makes bad law." *Id.* at 885.

[24] *Id.* at 894.

of it. So, Schauer's critique, I argue—and his critique of common law judging, generally—just does not apply to this court. And that is another aspect of the ingenuity of the system.

And finally, the "Chancery System," as I am calling it for just a shorthand this morning, cures for another important bias that has been shown to infect conventional common law systems. And that is the selection effect. The idea that once a legal rule is established, people are not going to bring lawsuits. Who sues on the basis of settled law? I will tell you who sues on the basis of settled law, my very good friends in the plaintiffs' bar. [*Audience Laughter*] Over and over and over again! How many times must we litigate whether 3.2% for a termination fee is going to—well, apparently a lot more! [*Audience Laughter*] But here is the point I want to make about this. I am not making light of it, but the argument here—and it is one that is against interest, and I will come back to that—is that there is actually some virtue in this, because the court sees each case. It sees each one of them. It sees the differences. It has the chance to reevaluate its policies the next time and the next time and the next time. It is not as though an issue is settled and then goes away forever, never to be readdressed. The issues keep coming back to the court. And it provides, in the court, the opportunity to revisit its rules, to tweak them, to improve them to the facts at hand, in an evolving and dynamic environment.

So the conclusion I wanted to drive to is that the judges of this court have evolved a system that remains true to a pure common law adjudicatory model, but nevertheless captures significant benefits that are attendant to a regulatory regime. In all the ways that I have been discussing this morning, the chancery M&A practice marries favorable attributes of agency regulation with a pure common law model, and in each instance for the better of the community that is in front of it. And in this way, it solves for certain systematic infirmities in the common law model.

It leaves for consideration a point I will not have time to get to today, but will be considering subsequently, and that

is what is the risk of over-regulation here? The burdens involved in litigating deal cases have increased exponentially over the past ten, fifteen years. But it has not happened with the opportunity for the kind of rigorous cost-benefit analysis that most regulators face by matter of statute. At what point does the incidence of filings outweigh the potential for any future benefits? What can be done to selectively screen cases to cure for that? How much can plaintiffs' lawyers be empowered as an enforcement crew before the costs and risks of potential distortion outweigh the benefits? How many times do we need to re-litigate the same issue? These are matter that can be addressed, and I would argue are being addressed, by the court, by levers of when to expedite cases, how to think about awarding fees, selecting as to who drives a case, even under what circumstances an order of dismissal might be possible under a deal case—which from the defense perspective is, unfortunately, seldom.

There is evidence this is already happening and I think it will continue to happen, and it will be extremely interesting to work though. Getting that right will be another example of what makes the court such a remarkable place to litigate and such a remarkable institution for effective judging in a terrifically complex economic environment. Thank you.

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MARK MORTON[25]: First, I want to echo Bill's praise for the chancery. It does a remarkable job with fast, thorough, predictable results that help all of us in practice, and I want to offer just a couple of comments from I think what would be at least a different, and, perhaps today at least, a unique perspective.

I am a sit-down lawyer, not a stand-up lawyer. I work on deals. I work with boards of directors, counseling them in deals. We take the guidance that Bill referred to in his presentation in all forms—cases, dictum, transcripts, articles, presentations, and programs—and we try and

[25] Partner, Potter Anderson & Corroon LLP.

implement that in our practice. It is a practice where, I think, it is fair to say, there is a challenge to be current, to absorb all of that information, and it is also an iterative process, where each day there is something new.

As Bill said, if you are monitoring blogs, if you are on the different corporate governance websites, it is almost every day where you could read something that you can roll into your practice that day. And so, while there is I think a great deal of benefit from dictum, and I think it helps all of us to get it right, I think at the same time, we probably should acknowledge that it creates challenges for all of us.

And so, it is in that context that I wanted to respond to the guidance aspect of Bill's comments, with a couple of thoughts about, as a practitioner again, what we might be sensitive to as we roll forward, how we can deal with the challenges that that system creates, and potentially, at least, guide it in another direction in some areas.

So, the first is whether or not it might not be, in a small way, better to say, "less is more"—at least more helpful. We probably cannot do anything to slow down the flood of transcripts that we all read, but there are challenges that it creates for us to practice.

Just to give sort of a concrete example: the way litigation on deals that we announce gets settled now. We refer to this in shorthand as either "disclosure settlement" or "disclosure plus settlement." If you believe you have independent directors, you have run a good process, but you have thirteen cases that are filed, you need find a good way to get those settled. And it is not uncommon, at least, for buyers to find a way to help the target to get those cases settled by agreeing to additional disclosures, agreeing to modifying terms in the merger agreement and, frankly much less frequently, agreeing to a process where there is more merger consideration.

In a system where it is iterative like that, and where there are transcript rulings that announce the results of those settlements, the challenge for us all is to then turn around and decide in the next deal, when you write the proxy statement or the information statement, what to say. What

do you disclose, in light of the six transcripts you read last week saying that they settled each of them providing for some additional level of disclosure? Do you treat that, in fact, as the new law that guides your practice? If you do not, what risk does that create?

One of the risks that you create is that if you either are not on top of that law, or if you decide that you do not believe those transcripts to be yet the law because they were merely the context of a settlement hearing, and you do not include in your disclosure documents some piece of information that otherwise in prior settlements would have been included, you may create an opportunity for—lack of a better word—"sandbagging." A stockholder, who may not even yet be a stockholder, may acquire shares after the announcement of the deal and may sit by passively waiting to see whether or not ultimately the disclosure "checks all the boxes" that they are aware of from the prior settlements. And then you may have a "quasi-appraisal" claim that occurs after close.

And that is one of the consequences, I would argue at least, of this iterative approach of so much guidance coming through secondary sources. I do not think that there is an easy solution to it because at present, at least, as Bill pointed out, we do have an extraordinary number of cases that get filed. Almost every deal, certainly. I used to say that for every deal over $100,000,000, there was a lawsuit. We are seeing suits filed on deals that are $50,000,000, $25,000,000 as well. So it is a challenge. I think it is a challenge for the practitioners. It is certainly a challenge for the court. They need to settle these cases. They need to find a way to settle. They need to evaluate carefully the appraisal claims that are being made. But, I think, we need to think about whether there is a way in which we can reconcile the remedies that might be created in the back end from disclosure claims that someone sat on and brought afterwards.

Secondly, I guess I would point out that with the benefit of dictum and the kind of guidance we are talking about, and the noble effort of courts to really synthesize the law, to create the sort of analytical constructs that are coherent and to offer that in the form of guidance in either dictum or

transcripts or articles—that it can create the law of unintended consequences in terms of the dynamics it creates in the deal settling. And so, one example, since Bill mentioned the *Hammons*[26] case, I think that is a good example. In that case, and in cases that have come since then, we have seen a suggestion that to the extent you can couple various or multiple prophylactic measures—a special committee, a majority and minority voting mechanism—that that will both give the court more comfort about the integrity of the process, and presumably, the stockholders as well since they have the ability to vote down a deal.

But what comes with that is, I would argue, in some circumstances, a loss in value. So, if you are on the target side, and you are gearing a deal towards getting to a certain type of standard of review, and as a result, working with a committee or seeking and getting a majority-minority voting mechanism, you may have a buyer who is willing to pay less because they are looking at the deal and saying, "That's a deal where I have less closing certainty. I am now conditioning my deal, not merely on the negotiating strategy that I have with you, the Special Committee, but upon the vote of a minority block of stockholders, where otherwise I would have at least a vote already in hand." Now, as a policy matter, that may be a perfectly valid place to come out, and we may all agree that that is the best way of replicating an arms-length transaction where you would have both the board and the stockholders voting on a transaction, and it would not be done sort of unilaterally through the board.

But in the *Hammons* case I think there was a bidder, as I recall, who put forth a conditional bid. The first price was one that was higher and did not require a majority-minority vote condition, and the second was a lower price. And so, from the perspective of the stockholder, I think we have to ask, "Is that a good or a bad consequence when it may result in a lower deal value at the end of the day?" Now, I think we at least have heard in one decision that ultimately, that is

[26] *See John Q. Hammons Hotels*, 2009 WL 3165613. *See also supra* note 22.

probably a good balancing of all the policies to accept that consequence. And I think that may well be the case. But right now, that is one of the challenges of integrating the guidance aspect of the law into practice and working with a committee to help them to understand that is something that you have to think through: Are you willing to trade things or not willing to trade things where it may have an impact on value?

The third comment I would make—and I do want to keep my remarks short here since we have several more people to speak—is that we should acknowledge that the guidance role is critical, but at the same time we should acknowledge on the deal side at least, that sometimes there is even greater value in the *in terrorem* effect of the law. Having the ability to point out to your client that, in fact, if they go in this direction and go too far, the guidance feature of the law may actually manifest itself in the form of injunctions—maybe not damages, because I am not looking for my independent directors to be held personally liable—has value. The risk of injunctive relief, if the board goes too far, or, put another way, if the board allows the buy side to push too hard and push them too far, can lead to actual deal process changes.

In practice we have not seen many injunctions outside the disclosure context and outside conflicted transactions. But I do wonder whether or not we end up having more leverage, ironically, on the target side if we are able to say, in a negotiated setting, to one of Bill's partners: "Well, we can't agree to x, y, z in the panoply of deal protections because we just do not think we can go there. We are concerned about injunctive risk." Even if that injunctive risk is not permanent injunctive risk—it is not killing the deal—but is delaying the deal as was done in the *Del Monte*[27] case.

[27] *See In re* Del Monte Foods Co. S'holders Litig., 25 A.3d 813 (Del. Ch. 2011). *Del Monte* concerned the acquisition of Del Monte Foods Co. by a group of private equity funds. The court of chancery enjoined a vote on the merger for twenty days, finding that collusion between the sell-side advisor and the private equity funds led to a flawed process to seek other potentially higher offers (a "go-shop") before the private equity transaction was finalized. *Id.* at 840.

Having the ability to push back hard that way, through that *in terrorem* effect, I think is ultimately beneficial because if you cannot, the buy side has the leverage to say to the target: "Look we're the only bidder in the room right now. You are not running a process. We came to you. The price of us staying and trying to present a really attractive offer to you is you are going to agree to these types of deal protections, at this level." And you cannot not tell your board that you cannot agree because it is a breach of duty to agree to do that. Because, absent the *in terrorem* effect or a jumping bidder, your stockholders will decide, not a court. There is a dynamic that that discussion creates that is difficult in the target board room, as a practical matter.

I am encouraged by a case like, and I may be in the majority or the minority in this audience, *Loral*[28] in a conflict context that comes up with very creative solutions as an equitable matter to a conflict problem, and a case like *Del Monte* outside the traditional conflict context,[29] that comes up with a creative solution that slows down the process, does not kill the deal, gives the court more comfort about the process, and sends a message to the market participants that you need to slow down. You, on the target side, need to push harder and have now the ammunition to do so. That *in terrorem* effect, while it may be a sort of a counterintuitive argument to ask for more decisions like those, as a deal lawyer I think it helps, at least on the sell side.

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[28] *See In re* Loral Space & Commc'ns Inc., C.A. Nos. 2808-VCS, 3022-VCS, 2008 WL 4293781 (Del. Ch. Sept. 19, 2008). In *Loral*, the chancery court found that Loral's board did not follow a fair process (in failing to make a "market check") when it entered into an agreement under which the company's controlling shareholder purchased a substantial additional equity interest in the company. Rather than invalidating the transaction, the chancery court "reformed" the agreement to convert the preferred stock that the shareholder would have received into non-voting common stock on terms it deemed fair to Loral. *Id.* at *32.

[29] *See Del Monte*, 25 A.3d at 840 (temporarily enjoining a vote on a merger to allow time for another potential bidder to emerge).

STEVEN DAVIDOFF[30]: What I want to do today for about, well, a little less then fifteen minutes is talk about *Airgas* and strategic decision making. I want to begin, perhaps by making my own strategic error, which is to say that I think *Airgas* is really a very unimportant case. It is a very unimportant case.

And why do I think it is historically unimportant? Well, I think there are two reasons. I think, first, the two opinions in *Airgas*, the bylaw one[31] and poison pill one,[32] would have had little effect no matter how they were decided. If the Delaware Supreme Court had upheld the chancery court bylaw decision, it would have likely pushed Airgas into the arms of Air Products or another third party. Make no mistake, it would have ended the bidding contest, I think. But frankly, who cares?

But I think a decision in favor of Air Products in the bylaw case would have had little impact on Delaware companies. Only fifty-eight Delaware companies in the Fortune 500 would have been affected by this opinion, by my count. Many have their annual meetings in the spring

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[31] *See* Airgas, Inc., v. Air Prods. & Chems., Inc., 8 A.3d 1182 (Del. 2010) Directors nominated by Air Products, a hostile bidder, sponsored a bylaw amendment that would have moved up the date of the annual shareholders meeting (at which Air Products hoped to gain control of the staggered Airgas board). The bylaw amendment also effectively shortened the terms of incumbent directors to less than the term set forth in the Airgas charter. The Delaware Supreme Court found that the charter provision defining directors' terms was ambiguous. The supreme court relied on extrinsic evidence to construe the charter provision and held that the bylaw amendment was inconsistent with the charter, and therefore invalid. The supreme court's decision reversed an earlier decision by the court of chancery. *See* Airgas, Inc., v. Air Prods. & Chems., Inc., C.A. No. 5817-CC, 2010 WL 3960599 (Del. Ch. Oct. 8, 2010) (construing the charter provision so that the bylaw amendment was not in conflict).

[32] *See In re* Airgas, Inc. S'holder Litig., 16 A.3d 48 (Del. Ch. 2011) (holding that the Airgas poison pill was neither coercive nor preclusive, taken on its own or together with a share repurchase plan and other defensive measures). *See also supra* notes 9 and 10.

anyway, so they would not have had this problem, and all these companies could have opted out of the decision by changing their charter provisions on the matter. It is really hard to do, but it could have been done. They could have simply moved their board meetings up in the spring. It would have solved the problem and made it go away. So I think the bylaw decision would not have had much effect.

As for the poison pill case, I think these issues were decided twenty years ago, thirty years ago, and I think perhaps on the poison pill, *Revlon*,[33] we may want to ignore history. It is a very different market, *Revlon* is very different. But these decisions have been made, and we are moving forward. If Chandler had ruled to revoke the poison pill, and the Supreme Court, which no one thought they would, would have upheld that decision, we really would be talking about a small group of companies being affected—companies with a staggered board where a hostile bidder had won a short slate. How often does that happen? It is a handful of companies, and frankly this is why it took over twenty years for this issue to come to a head. So I do not think *Airgas* is an important case, except for maybe Airgas itself and the parties involved.

But I do think it is important because it really reveals a lot about Delaware and how they strategically decide cases. I am an academic. I moonlight as "the Deal Professor," which is how many of you know me, but we will throw some

[33] *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 501 A.2d 1239 (Del. Ch. 1985), *aff'd*, 506 A.2d 173 (Del. 1986). Revlon rebuffed a series of hostile offers from a company controlled by Ron Perelman and adopted a variety of defensive measures. At the same time, the Revlon board entered into exclusive negotiations with a "white knight" acquirer, private equity firm Forstmann Little & Co., and ultimately entered into an agreement with Forstmann that prevented an active auction of the company. The chancery court found that the board had breached its fiduciary duty in foreclosing other potentially higher bids. The court noted that, once the board decided to sell the company, even as a defensive measure, "[t]he directors' role changed from that of a board fending off a hostile acquiror bent on a breakup of the corporation to that of an auctioneer attempting to secure the highest price for the pieces of the Revlon enterprise." *Id.* at 1248.

theory in here, okay? I think we have jurisprudential theory. Legal theory has several models about how judges decide cases. There is the realist view, the formalistic one—we saw that in the slavery cases we read way back when—and there is a strategic mode of decision making that we often see.

In the strategic mode, judges decide their cases, based in whole or in part, by catering to their wider interest—be it political, reputation, or otherwise. I put forth that Delaware is really ripe for examination for strategic decision making due to its unique position. It is a jurisdiction where the judges, legislature, and bar are very attuned to keeping Delaware corporate law in line with expectations. I think they do, frankly, an excellent job of that. As Bill Savitt said, even these conferences can be seen as "notice and comment" review of Delaware decisions. So, Delaware is out there. Delaware is engaging. Delaware might have incentives to strategically decide cases.

Let us do a thought experiment and perhaps examine this in the context of the *Airgas* case. Here I have to iterate professor Gilson's line a little differently. My wife would call it *chutzpah*, which is to sit here and talk about judge's decisions while they're actually looking at you. It is very easy for an academic perhaps to say, "You should have done x or y." I think we need to take it with a grain of salt. But we are trying to put an archetype around these decisions, and give it a thoughtful framework for analysis going forward. So with that big caveat, I am going to go forward and respectfully give my thoughts.

I think Chancellor Chandler, in his bylaw opinion, applied what was thought to be well-established legal principals to uphold the bylaw amendment. And I think there are reasons to enforce the bylaw to allow it to be amended in the manner Air Products proposed and the Airgas shareholders approved. Legal principals from the *Centaur*[34] case—we want to encourage good drafting by

[34] *See* Centaur Partners, IV v. Nat'l Intergroup, Inc., C. A. No. 11354, 1990 Del. Ch. LEXIS 22 (Del. Ch. Mar. 7, 1990), *aff'd*, 582 A.2d 923 (Del. 1990). Hostile bidder Centaur Partners challenged a provision of the charter of National Intergroup that required an 80% supermajority

lawyers—these militated in favor of Chancellor Chandler's decision. There were also policy reasons to support Chancellor Chandler's ruling.

If you did not like Chancellor Chandler's decision, we had a private ordering solution. We also had an application of what were thought to be well-established principals of law about how to interpret bylaws in the face of ambiguity. The Supreme Court just felt differently. I think Wachtell Lipton did a fantastic job; I see Gary Bornstein in the audience, Cravath did a fantastic job. We should frame those briefs and they should still be on bed rest for the amount of time and expenses put into them.

We could debate the strength of legal reasoning of Chandler's opinion and the Supreme Court opinion. But I do think, and I am going to put forth, that the Supreme Court opinion was driven largely by strategic considerations. I think it can be argued that there were a couple of things at issue here. I think the Delaware Supreme Court acted to preserve a full sale process. A Supreme Court verdict for Air Products would have placed Airgas into a bind. Airgas would have faced a January meeting and would likely have lost. A verdict for Air Products would have forced Airgas to the bidding table. Airgas would not have gotten seventy-eight dollars a share. It would have gotten seventy dollars, seventy-one dollars—which is about where it is right now. The Supreme Court acted strategically to keep an open playing field.

There is a second strategic reason for this decision. I do not want to overstate it. I just want to put it out there for people to consider. We mentioned the, frankly, legendary

shareholder vote before the board of directors could be enlarged. Centaur argued that the charter provision was ambiguous when taken together with provisions of the National Intergroup bylaws. The chancery court found no ambiguity in the plain language of the charter. The supreme court affirmed, noting that "[c]orporate charters . . . are contracts among the shareholders of a corporation" and that "courts must give effect to the intent of the parties as revealed by the language of the certificate and the circumstances surrounding its creation and adoption." *Centaur Partners*, 582 A.2d at 928 (quotation and citation omitted).

Marty Lipton and his famous memo in the wake of *Interco*,[35] arguing that Delaware risked the possibility of reincorporation elsewhere.[36]

While I think the implications of *Airgas* are little, this was a high-profile case. Everyone was following it. The risk of a decision that did not preserve the staggered board was significant because it risked Delaware's corporate law case law, or at least could have been perceived to do so.

I would like to take each of these comments in turn and sort of examine them, and put them in a framework and draw some conclusions in my remaining time.

Let us take the open playing field. I think this was a risky endeavor, to the extent that this opinion was driven to keep an open playing field for bidding. I think, first of all, it substitutes the court's judgment for the proper price in place of two constituencies that probably know it better. We can order them how we want, but they are the shareholders and directors. Second, I think it puts the court in a situation that it wants to avoid: assessing information when there is asymmetry. There's a third reason. It exposes the court to the wrong decision. I mean, *Airgas* made the right decision in retrospect. Its share price is seventy dollars a share. Yahoo made the wrong decision.[37] As a court, you are just

[35] *See* City Capital Assocs. Ltd. P'ship v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988), *appeal dismissed as moot*, 556 A.2d 1070 (Del. 1988) (invalidating a poison pill); *see also supra* note 7.

[36] Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 625–26 (2003) ("The *Interco* case and the failure of Delaware to enact an effective takeover statute, raise a very serious question as to Delaware incorporation. New Jersey, Ohio and Pennsylvania, among others, are far more desirable states for incorporation than Delaware in this takeover era. Perhaps it is time to migrate out of Delaware.") (quoting Letter from M. Lipton, Wachtell, Lipton, Rosen & Katz, to Clients (Nov. 3, 1988) (internal quotation marks omitted)).

[37] Between February and May of 2008, Yahoo!'s board of directors rejected a series of takeover bids from Microsoft. In May, 2008, Microsoft abandoned its pursuit of Yahoo!. *See, e.g.*, Miguel Helft & Andrew Ross Sorkin, *Microsoft Withdraws Bid for Yahoo*, N.Y. TIMES, May 4, 2008, at A1.

substituting your judgment in those circumstances. It really puts you at risk in there.

And finally I think that the court acted to preserve the notion of director primacy, which I think is an important principle. I think there are real questions about empowering shareholders in the corporate form. But I think that there might have been a misapprehension here, which is that when we are talking about the shareholder franchise rather than the operation of the company, perhaps we should favor shareholders. That was how we viewed the interpretation of bylaws under the *Centaur*[38] opinion and previously. There are real reasons for that.

I think there are real reasons why it was dangerous to move forward on this basis. I think, as long as we are talking here, there was an undertone to this opinion about the conflicts between short-term and long-term shareholders, and their interest in takeovers. I think this is a real debate that needs to be had, but I think it needs to be had and *fleshed out*. I mean, short-term shareholders may sell and force the company to do short-term decisions, but they are also, perhaps, more incentivized to say "no" and bear more risk.

Compare this to the institutional shareholders who sold to the short-term shareholders—which is a bit trite, but it is true—or those who stay in and are unwilling to vote "no" against a merger. You are an institutional shareholder. You are faced with a premium. Are you really going to risk it out and face a "Dynegy" situation,[39] or are you going to vote "no"? There they voted "no," but in other circumstances they voted "yes." I think there needs to be a fuller flesh-out, before we

[38] *See Centaur Partners*, 582 A.2d at 927; *see also supra* note 34.

[39] In late 2010, Dynegy Inc. shareholders rejected a proposed takeover bid by The Blackstone Group. *See* Michael J. De La Merced, *Ending Blackstone Talks, Dynegy Seeks New Buyer*, N.Y. TIMES DEALBOOK (Nov. 23, 2010, 7:09 PM), http://dealbook.nytimes.com/2010/11/23/dynegy-cancels-blackstone-deal/. In 2011, Dynegy filed for Chapter 11 bankruptcy protection. *See* Mike Spector, *Dynegy Files for Unusual Bankruptcy*, WALL ST. J., Nov. 8, 2011, *available at* http://online.wsj.com/article/SB10001424052970204554204577024311666924248.html#.

drive decisions based upon short-term or long-term shareholders, on what their interests are. I am not making conclusions one way or the other, but I think we need to look at that.

I think with respect to the wider strategic issues of Delaware's prominence, I largely agree with the commentators that perhaps the "race to the bottom, race to the top" is over-emphasized. But, in this context, to the extent that *that* was the motivation, it probably was the wrong case. The risk of corporate flight in the bylaws case as opposed to other cases was minimal. The case affected a small number of companies, who even then could contract around the decision's effects. And I think it may have overestimated the problem with the wrong bylaws decision.

Against these small gains, the risk of a strategic decision has to be weighed. A strategic decision perhaps erodes the rule of law as litigants cater to wider interests rather than the matter at hand. It creates subjectivity in the law, which can come back to haunt the judiciary, as personnel changes come and the law changes.

But I do not want to say strategic decision making is a bad thing. I think it can be very prudently employed, and I am going to hold up the second *Airgas* opinion as perhaps an example of that circumstance, in two ways.

I am going to take the wider issue first. I think the issue in the poison pill case was, one, how did Chandler write his opinion? There are some interesting things to say there that I am not going to have time for, about how the chancery court speaks to the Supreme Court and yet preserves its own autonomy. Chancellor Chandler could have written that opinion in many ways. He could have decided for Air Products and just put it to the Supreme Court. He could have decided for Airgas and not written the dictum that he did. But he did say that "I do not believe this should be the law." And I view that—and again this is *chutzpah* because I am putting words in Chancellor Chandler's mouth—this is a way to both cater to wider constituencies, acknowledge the problem, or perhaps damp out any protests, and let Air Products decide if they wanted to raise the issue with the

Supreme Court—which they did not. I think, second of all, it allowed Chancellor Chandler to preserve the autonomy of the chancery court, expressing that we have our own opinions and we are going to register them.

One more point before I get to my final conclusions. If this had gone up to the Supreme Court and they had ruled for Airgas, the decision would have been, on the metrics I am using, probably a sounder strategic decision. You cannot contract around this poison pill case. You cannot do private ordering in that circumstance. It, perhaps, could affect wider constituencies because of the focus that goes on strategic takeovers and takeover defenses in Delaware, and how sensitive that all is.

And finally, in exercising strategic authority, we need to make a distinction between overt strategic decisions, where it appears to predominate, and long-term strategic decisions. The poison pill case, as it was decided by Chandler—taking out the dictum—and as it might have been decided by the Supreme Court, upholding for Airgas, was implementing a longer-term strategic decision, which I think is a better way to steer how the courts go.

Just a few final points. I am not saying this is all realpolitik and judges get up and say, "What's our best strategic decision of the day?" I think Delaware judges are, frankly, fantastic, extremely competent, and have created a viable corporate ecosystem that works. Of course, the law matters. But I am suggesting in certain circumstances strategic decisions could come into play and need to come into play. Professors Rock and Kahan have talked about this in *Bear Stearns*.[40] This was really not a decision that you

[40] *See* Marcel Kahan & Edward Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 EMORY L.J. 713 (2009). Professors Kahan and Rock note:

> The Bear Stearns-J.P. Morgan Chase merger placed Delaware between a rock and a hard place. On the one hand, the deal's unprecedented deal protection measures—especially the 39.5% share exchange agreement—were probably invalid under current Delaware doctrine because the measures rendered the Bear Stearns shareholders'

wanted to make, challenging the Federal government. Vice Chancellor Parsons artfully dodged that issue on strategic considerations.[41]

But what I do want to say is, while my conjecture can be debated, I think one of the things we have to do is analyze. We can use the *Airgas* case to see how strategic decision making can work to further the long-term interests of the court, by avoiding cases—bad facts make bad law—by looking out for the longer-term interests, by steering the court in a strategic direction. But it needs to be careful. When the decisions do not appear to be based upon the law, when it appears to be based upon those wider considerations, it might impugn the authority of the court. I think as the court goes forward, it needs to be careful of these considerations. Thank you.

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MARTIN LESSNER[42]: Thank you. The professor made some good points on *Airgas*—how Delaware decides cases and what drove the Supreme Court. It is interesting to me that there are so many people here involved in *Airgas*. There was a movement last night to take a group picture.

My role as a practitioner was in the background. I represented a bunch of arbitrageurs and kind of provided a "play-by-play" as the case unfolded so that the "arbs" could

> approval rights entirely illusory. On the other hand, were a Delaware court to enjoin a deal brokered by the Federal Reserve and the Treasury Department, and arguably necessary to prevent a collapse of the international financial system, it would invite just the sort of federal intervention that would undermine Delaware's role as the de facto provider of U.S. corporate law.

Id. Faced with this choice, the chancery court took advantage of a pending New York action to stay the case and avoid making a decision. *Id.*

[41] *See In re* Bear Stearns Cos., Inc. S'holder Litig., C.A. No. 3643-VCP, 2008 WL 959992 (Del. Ch. Apr. 19, 2008) (granting a stay in the case challenging the Bear Stearns merger with J.P. Morgan); *see also supra* note 40.

[42] Partner, Young Conaway Stargatt & Taylor, LLP.

decide where to place their money. So, I was kind of the Howard Cosell of *Airgas*. Now in Chancellor Chandler's *Airgas* decision, he notes that the debate about who ultimately decides whether a tender offer is adequate and should be accepted, the shareholders or the board, has long engaged practitioners, academics, and members of the judiciary. As a practitioner, it would be terrific to find some sort of "unified field theory," a way to safely predict the judicial outcomes based on a set of facts, or maybe better yet, a set of facts that can be unearthed and discovered. But I have yet to find it.

However, I think the *Airgas* opinion sheds a little light on the interaction of our M&A law and its influence on our corporate governance law.

Now as far as mergers and tender offers, I think it is safe to say that our law is board-centric. That is, Delaware law recognizes the primacy of board decision making. In the merger context, the decision not to pursue a merger, or even a decision not to engage in negotiations at all, is viewed under a deferential business judgment standard. A board can just say "no." In a tender offer context, I think it is getting pretty close. A decision not to redeem a pill in the face of a hostile tender offer is viewed under intermediate scrutiny, and it must be *reasonable* in relation to the threat posed by such an offer. However, as in *Airgas*, for an independent, well-advised board acting in good faith, a decision to keep a pill in place in the face of an inadequate tender offer is almost certainly going to be upheld. The outcome is going to be very similar to the merger context, almost a business judgment standard.

However, *Airgas* was an easy case in this regard, because the Chancellor held that the Supreme Court equated inadequate with, quote, "a lowball bid." The Chancellor found that the *Airgas* board could properly conclude that Air Products' offer clearly *undervalued* Airgas and that the board, in good faith, believed that the offer was inadequate "by no small margin."

The harder case, I think, is yet to come. That is, what if a board and its investment bankers conclude that an offer

between, say, eighteen dollars and twenty-two dollars, was fair from a financial point of view? And what if an acquirer made a tender offer right in the middle at twenty dollars? Twenty dollars clearly would not be inadequate. So how could that be a threat that would justify the pill? However, suppose the board wanted not just a fair price, but the board wanted a *top* price. Can a good, but not best, price be considered a threat, such that the directors, and not the stockholders, continue to make the ultimate decision regarding the tender offer? Or does this scenario take our board-centric review too far?

Now it is my observation that the board-centric review used in mergers and tender offers started to spill over to the corporate governance area, with its traditionally stockholder-centric review Now it would not be, I guess, a forum honoring Vice Chancellor Strine without reference to an obscure 1980's song. [*Audience Laughter*]

So, I was thinking of the 1980's song by the group They Might Be Giants, who wonders what happens in a fight between "Universe Man" and "Triangle Man."[43] Triangle Man wins, by the way. But this clash can be seen when you look at the bylaw opinion the Chancellor wrote in the chancery court, and the Supreme Court's opinion. In the first paragraph of his opinion, the Chancellor frames the issue as whether the bylaw would cause Airgas' annual meeting to be held in January as opposed to August. It focuses on whether the term "annual" means "separated by twelve months" or "occurring once a year." Having framed the issue in a corporate governance way, the Chancellor noted a couple of fundamental principles: for corporate charters, bylaws, or contracts, the rules of contract interpretation will apply. Presented with ambiguity in interpreting bylaws, doubt is resolved in favor of the stockholders electoral rights.

[43] *See* They Might Be Giants, Particle Man, *on* Severe Tire Damage (Rounder Select Records 1998).

The policy of this construction is based on the belief, articulated in *Blasius*,[44] that the stockholder franchise is the underpinning of the legitimacy of director powers, and that the Delaware General Corporate Law is an enabling statue. It gives the parties great deference in what they want to do. The Chancellor also noted a well-established law that directors, we presume, comply with their fiduciary duties unless proven otherwise. Once *in office*, if insurgents engage in improper purposes, equity will then stand guard and be ready to provide a remedy if there's any abuse. Using this stockholder-centric view, the Chancellor held that the bylaw was valid, and that, in the absence of a specific date or time the directors already set, the directors and stockholders of the corporation are free to choose such a date.

Now in reversing, the Supreme Court viewed the bylaws through a different lens. That was the lens of a threat to Airgas, in which a director-centric standard would apply. Right from the start—very first paragraph, very first sentence—the Supreme Court starts up by saying Airgas and Air Products are *competitors*. No mention of bylaws or annual meetings—they are competitors. There is a tender offer launched, and the Airgas board rejected several of the bids as undervaluing the company and inadequate—this is a takeover attempt.

Now the focus of the Supreme Court was that the bylaws were just part of a takeover bid, an attempt to get around the Airgas staggered board, which the Supreme Court viewed as an important takeover defense. The Supreme Court noted that the defense has been around since 1899, and that this was a kind of precursor to the poison pill. It enhanced the bargaining power of a target board. The proxy fight and the bylaw setting the meeting date, the original issue in front of the chancery court—a traditional area of stockholder-centric decision making—in the Supreme Court's view was subsumed to the directors' duties in fighting an inadequate tender offer. As the Supreme Court noted, Air

[44] *See* Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988) (requiring a "compelling justification" for board actions the primary purpose of which is to prevent a shareholder vote); *see also supra* note 12.

Products could have negotiated with the board to agree on a mutually beneficial price. Instead, Air Products chose to wage a proxy contest to facilitate its tender offer. The proxy contest and the bylaws were simply part of its takeover strategy. Viewing them in this lens, the Court held the bylaws were invalid.

I think this view was echoed by the Supreme Court a couple of years before in the *Computer Associates* decision, in which it invalidated bylaws which provided for election expense reimbursement for successful insurgent candidates.[45] I believe the court viewed insurgent directors as a threat when the proxy contest was motivated by petty personal interests or interests that would promote interests adverse to the corporation's.

Again, it is a different view. Instead of viewing that we presume directors comply with their fiduciary duties and if there is a breach we will provide a remedy afterward, the Supreme Court, I believe, is now saying that directors have a duty within their business judgment to evaluate incoming directors and insurgent directors. I think under *Blasius* the courts had not previously assumed that to be an area for incumbent directors. It is interesting to note that the Supreme Court, in its example, again used the word "competitor" much like they did in *Airgas*, in saying that one of the problems or circumstances that could arise was that an insurgent slate could be affiliated with a competitor. If they got on the board, they might communicate valuable and proprietary strategic information to the competitor.

[45] *See* CA, Inc. v. AFSCME Emps. Pension Plan (*Computer Associates*), 953 A.2d 227 (Del. 2008). In *Computer Associates*, shareholder AFSCME proposed a bylaw that would have required the company to reimburse shareholders for reasonable expenses incurred in conducting successful proxy contests. *Id.* at 230. The Delaware Supreme Court held the bylaw invalid because "the [b]ylaw mandates reimbursement of election expenses in circumstances that a proper application of fiduciary principles could preclude." *Id.* at 240.

Finally, the recent case of *Yucaipa v. Barnes & Noble*,[46] was another pill case, but a pill case not in the context of tender offer, but in the context of what, we argue, was a corporate governance issue. The court found that electing three out of nine board seats was a significant event. Once the insurgents had won the election, they had an ability to influence the rest of the board. There was a possible threat that these new directors could influence company business strategy, including proposing a possible M&A transaction. Now the interesting part, at least to me, about *Yucaipa* was that the pill in that case locked in an electoral advantage by the thirty-plus-percent stockholder, such that in any proxy contest—the ultimate relief valve to get rid of the pill—the insurgents in that case would need about seventy-five percent of the unaffiliated vote expected to vote at a meeting. The court held that this was not preclusive; it said it was obviously a lift, not a Herculean lift.

But I contrast this with Chancellor Chandler's opinion in *Airgas*, in which he found that if you need eight-five percent of the vote that would be preclusive. So you have a range where eight-five percent is preclusive, not reasonably attainable, seventy-five percent a Herculean lift, but still attainable. No decisions in between, anything less than eighty-five percent. I guess, in sum, it seems to me that the *Airgas* decision by the Supreme Court, in the bylaws case, and by the Chancellor, in the pill case, illustrate our director-centric preference to decision-making by directors, and that this view will be applied in cases touching on

[46] *See* Yucaipa Am. Alliance Fund II, L.P. v. Riggio, 1 A.3d 310 (Del. Ch. 2010). In *Yucaipa*, the board of directors of Barnes & Noble adopted a poison pill that would be triggered by the purchase of 20% of the company's outstanding stock shortly after the Yucaipa Fund had acquired an 18% interest. Yucaipa challenged the poison pill, in part on the grounds that the trigger was set at a level lower than the 30% stake already owned by the family of the company's founder. *Id.* at 312–13. The chancery court upheld the poison pill, as a reasonable and proportionate response to the Yucaipa takeover threat. *See id.* at 313 (noting that the poison pill was to be subject to a shareholder vote within a year, "a feature that further limits its inhibiting potency").

corporate governance, even in some cases which formally we may have viewed as being an area of stockholder primacy.