Tender Offers by Controlling Shareholders: The Specter of Coercion and Fair Price

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Tender Offers by Controlling Shareholders: The Specter of Coercion and Fair Price

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INTRODUCTION

Taking your company private has never been so appealing. The collapse of the tech bubble has left many companies whose stock prices bordered on the stratospheric now trading at small fractions of their historical highs. The spate of accounting scandals that followed the bursting of the bubble has taken some of the shine off the aura of being a public company—the glare of the spotlight from stock analysts and the business press looks much less inviting, notwithstanding the monitoring benefits that the spotlight purports to confer. Moreover, the regulatory backlash against those accounting scandals has made the costs of being a public company higher than ever. The passage of the Sarbanes-Oxley Act of 2002 has brought a host of costly new requirements for public companies affecting both disclosure and corporate governance. Securities fraud class actions are booming, and rates for D&O insurance are correspondingly skyrocketing. Auditors’ fees have also spiked, reflecting the greater expectations imposed on accountants to ferret out corporate wrongdoing, and the commensurately greater risk of liability. Who needs it?

As it happens, Delaware has a fire sale on going private for one group that might be particularly interested—controlling shareholders. In addition to the risks enumerated above, corporations with controlling stakes in subsidiaries

* Professor of Law, University of Michigan Law School. I am grateful to participants at the symposium on “The Role of Law in Promoting Long-term Value for Shareholders,” sponsored by the Berkeley Business Law Journal and the Mercatus Center (2003), as well as Mark West for helpful comments on earlier drafts of this Article.


2. Andrew Countryman, Law’s Effects Pile up on Firms; Sarbanes-Oxley’s Internal Controls Rules Prove Costly, CHICAGO TRIBUNE, July 20, 2003, at C1 (reporting increased compliance costs due to law).


4. Theo Francis, It Still Costs Big to Insure Against a Boardroom Scandal, WALL ST. J., July 31, 2003, at C1 (reporting annual increases in the 25 percent to 30 percent range after premiums doubled or tripled post-Enron).

5. OBSERVER COLUMN, FINANCIAL TIMES, July 17, 2003, at 12 (“Companies expect audit fees to rise by a third . . . according to a survey by Financial Executives International.”).
have to worry about the risk of derivative litigation on behalf of minority shareholders. This risk arises from the fact that all of the controlling shareholder’s transactions with their controlled subsidiary are potentially subject to the “entire fairness” standard, the most demanding regime in corporate law. That same standard makes it difficult for controlling shareholders to escape the risks of derivative lawsuits (and other costs of holding a control bloc in a public subsidiary) because Delaware courts impose the entire fairness standard on mergers between parent corporations and their subsidiaries. The result is that, until recently, freeze-out mergers to eliminate minority shareholders have been procedurally complicated, expensive and a target for litigation.

A recent series of cases from the Delaware courts, however, has blazed a path for controlling shareholders to freeze out minority shareholders with minimal procedural hurdles and commensurately minimal litigation risk. By combining a tender offer to minority shareholders with a follow-up “short-form” merger under Section 253 of the Delaware General Corporate Law, controlling shareholders can eliminate minorities while avoiding the demanding requirements of “entire fairness”. The attraction for controlling shareholders is obvious, but is the tender offer/short-form alternative a good thing or a bad thing for investors? The commentators to date have generally concluded that minority shareholders are likely to be harmed. Alternatively, they claim that this development undermines the doctrinal consistency of Delaware corporate law by their inability to extract a greater premium from the controlling shareholder.

This Article dissents from that consensus: my bottom line is that the streamlined regime is likely to be positive for shareholders and that doctrinal purity is not worth worrying about. To be sure, minority shareholders would always prefer more to less in exchange for their shares, and the entire fairness regime—and the elaborate procedural apparatus that it has spawned—might generate more generous offers from controlling shareholders. But wealth transfers between shareholders of subsidiary corporations and shareholders of parent corporations are largely a social wash—one group’s increased wealth exactly offsets the other’s diminished wealth. The risk of misappropriation will be factored into the amount that investors will be willing to pay for a minority stake, or into the premium necessary to obtain control. Requiring a second control premium serves little useful purpose. Moreover, the most egregious

8. See infra Part I.
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over-reaching will be deterred by the need to encourage minority shareholders to tender. On balance, less law is likely to produce more value for shareholders in this context.

Of equal importance, from an institutional perspective, this streamlined procedure is not a judicial innovation, but instead, well grounded in the overall structure of Delaware corporate law. The entire fairness mandate is a reasonable (if not inescapable) interpretation of the obligations imposed on corporate boards by §251. There is no similar statutory mandate under §253, nor is there any role prescribed for boards in connection with tender offers. Consequently, the end run around the entire fairness regime threatens no new incursion into the authority of corporate boards, the importance of which is recognized by the business judgment rule. Moreover, the streamlined procedure developed by the Delaware courts respects the careful balance between the paramount role of the Delaware General Corporate Law and the interstitial role of courts in spelling out the common law of fiduciary obligation. Fiduciary obligation fills in the gaps of the corporate code—it is not intended to supplant statutory law, or transform it into an "ideal" corporate law.

The Article proceeds as follows: Part I sketches the "entire fairness" regime, Part II traces the development of the tender offer/short-form alternative and Part III addresses objections to that alternative. I summarize the main points in a brief conclusion.

I. ENTIRE FAIRNESS

A. Application to Mergers

1. Weinberger

The general rule, long established in Delaware and elsewhere, is that controlling shareholders owe a fiduciary duty to the corporation and minority shareholders. This obligation requires that a parent company, when it engages in "self-dealing" with its controlled subsidiary, demonstrate that the terms of the transaction are entirely fair to the subsidiary.10 Not surprisingly, the Delaware Supreme Court included mergers between the parent and subsidiary in the category of "self-dealing" transactions when the issue arose in Weinberger v. UOP, Inc.11 Although the defendant, Signal Companies, attempted to shift the burden on the issue of entire fairness by making the merger subject to approval by a majority of the minority shareholders, its attempt failed because of its failure to disclose all material information to the

Specifically, it failed to disclose a study by two UOP directors (Arledge and Chitiea, who were also Signal directors) on the feasibility of a buyout of UOP's minority shareholders. "Using UOP data, it described the advantages to Signal of ousting the minority at a price range of $21 to $24 a share." Given that the price offered in the merger was $21, the court concluded that Signal's willingness to pay $24 would have been important information for the minority shareholders confronted with the choice of either voting for the merger or dissenting and seeking appraisal. Obviously, this was material to the minority shareholders, but the duty question was harder. Did controlling shareholders have to reveal their reservation prices in all circumstances? Did fairness require self-sacrifice by the majority shareholder? Weinberger was ambiguous with respect to these questions.

Perhaps more significant than the court's holding, however, was a footnote suggesting an alternative procedure:

Although perfection is not possible, or expected, the result here could have been entirely different if UOP had appointed an independent negotiating committee of its outside directors to deal with Signal at arm's length... Since fairness in this context can be equated to conduct by a theoretical, wholly independent, board of directors acting upon the matter before them, it is unfortunate that this course apparently was neither considered nor pursued... Particularly in a parent-subsidiary context, a showing that the action taken was as though each of the contending parties had in fact exerted its bargaining power against the other at arm's length is strong evidence that the transaction meets the test of fairness... This footnote was a strong hint to transactional planners about the court's preferred method for determining price in a freeze-out merger: arm's length bargaining. Left unanswered, however, was a fundamental procedural question: How strong would evidence of an arm's length bargain be in establishing fairness? Would it be enough to secure the protections of the business judgment rule?

2. Rosenblatt

The answer to the first question soon followed. Just two years later, in Rosenblatt v. Getty Oil Co., the court held that a majority shareholder need not disclose its reservation price to establish the fairness of a squeezeout:

While it has been suggested that Weinberger stands for the proposition that a majority must under all circumstances disclose its top bid to the minority, that clearly is a misconception of what we said there. The sole basis for our conclusions in Weinberger regarding the non-disclosure of the Arledge-Chitiea report was because Signal appointed directors on UOP's board, who thus stood on both sides of the transaction, violated their undiminished duty of loyalty to UOP. It had

12. Id. at 712.
13. Id. at 708.
14. Id. at 712.
15. Id. at 709 n.7.
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nothing to with Signal’s duty, as the majority stockholder, to the other shareholders of UOP.\(^6\)

As clarified by *Rosenblatt*, the entire fairness regime established for mergers in *Weinberger* stands for two rather unremarkable propositions. First, directors of a subsidiary owe that firm a duty of undivided loyalty; allegiance to the parent firm cannot dilute that bedrock duty. Second, the parent corporation cannot expropriate assets from the subsidiary, such as the non-public information contained in the Alredge-Chitiea report. It does not stand for the proposition that all of the gains from the transaction must go to the minority.

3. *McMullin*

The importance of property and statutory rights in the entire fairness analysis is reinforced by *McMullin v. Beran*.\(^7\) *McMullin* arose out of Atlantic Richfield Company’s (“ARCO”) efforts to sell its 80 percent-owned subsidiary, ARCO Chemical (“Chemical”).\(^8\) ARCO was anxious to sell its stake in Chemical to pay down debt accrued in financing the acquisition of another subsidiary.\(^9\) Chemical’s board, recognizing that ARCO’s 80 percent stake gave it veto power over any transaction involving Chemical, delegated its authority to negotiate the sale of the company to ARCO.\(^10\) ARCO negotiated a deal with Lyondell Petrochemical for a tender offer for Chemical shares at $57.75 per share, to be followed by a second-step merger at the same price.\(^11\) ARCO committed to tendering its 80 percent stake into the tender offer, thus making the deal, as it was presented to the Chemical board, essentially a *fait accompli*.\(^12\) The Chemical board could withhold its consent, but Lyondell could override that refusal after it acquired ARCO’s stake by replacing the Chemical board.

Notwithstanding the reality of ARCO’s voting power over Chemical, the Delaware Supreme Court concluded that the Chemical board had breached its fiduciary duty to the minority by failing “to make an informed and independent decision on whether to recommend approval of the third-party transaction with Lyondell to the minority shareholders.”\(^13\) This fiduciary duty arose out of the “statutory duty imposed under 8 Del. C. § 251 ‘to act in an informed and deliberate manner in determining whether to approve an agreement of merger before submitting the proposal to the stockholders.’”\(^14\)

\(^{16}\) 493 A.2d 929, 939 (Del. 1985).
\(^{17}\) 765 A.2d 910 (Del. 2000).
\(^{18}\) *Id.* at 914.
\(^{19}\) *Id.* at 921.
\(^{20}\) *Id.* at 915.
\(^{21}\) *Id.* at 916.
\(^{22}\) *Id.*
\(^{23}\) *Id.* at 924.
\(^{24}\) *Id.* at 917 (quoting Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985)).
Form matters here. ARCO clearly could have sold its 80 percent stake—for whatever price it could negotiate—without any involvement from the Chemical board. The Chemical board would have had no role to play in those negotiations. By instead negotiating an acquisition agreement that required the Chemical board’s assent under § 251 because of the agreed-upon follow-up merger, ARCO implicated the Chemical board’s duty to recommend only value-maximizing offers to the Chemical shareholders.25

One caveat is worth noting here: if ARCO had required concessions from its subsidiary, the Chemical board’s fiduciary duties might have been implicated in connection with the sale of only its stock. For example, in In re Digex, Inc. Shareholders Litigation,26 the board of the subsidiary breached its fiduciary duties by agreeing to waive the protections of § 203 in connection with the merger of its parent corporation. Digex follows closely from Weinberger (and for that matter, Sinclair): rights held by the subsidiary corporation (whether conferred by common law or statute) are to be exercised for the benefit of the subsidiary, not the parent. The subsidiary must receive fair consideration for waiving those rights.

B. Procedures

1. Kahn

The answer to the procedural question left open in Weinberger took longer to resolve. In Kahn v. Lynch Communication Systems, the Delaware Supreme Court held that “approval of the transaction by an independent committee of directors or an informed majority of minority shareholders shifts the burden of proof on the issue of fairness from the controlling or dominating shareholder to the challenging shareholder plaintiff.”27 The court also held, however, that whatever the procedures adopted to protect the minority, the business judgment rule standard would not apply to a merger with a controlling shareholder; rather, the standard would remain entire fairness.28 The court justified its refusal to confer business judgment protection because of the perceived risk of potential retaliation by the majority:

Even where no coercion is intended, shareholders voting on a parent subsidiary merger might perceive that their disapproval could risk retaliation of some kind by the controlling stockholder. For example, the controlling stockholder might decide to stop dividend payments or to effect a subsequent cash out merger at a less

25. Id. at 920 (noting that sale of entire company, “rather than selling only its own 80 percent interest,” implicated Revlon duties).
27. 638 A.2d 1110, 1117 (Del. 1994).
28. But see Model Bus. Corp. Act § 8.61(b)(1)-(2) (altering standard to business judgment when merger is negotiated by an independent special committee or ratified by an informed minority).
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favorable price, for which the remedy would be time consuming and costly litigation.29

The refusal to shift the standard from entire fairness to business judgment was significant because of the incentives it gave to the plaintiffs' bar. Not only did the court refuse business judgment protection for the work of special committees, but it also mandated "careful judicial scrutiny of a special committee's real bargaining power before shifting the burden of proof on the issue of entire fairness."30 Consequently, application of the entire fairness standard, even if the controlling shareholder was likely to eventually prevail, "normally will preclude dismissal of a complaint on a Rule 12(b)(6) motion to dismiss."31 A claim that can withstand a motion to dismiss may have settlement value, if only to avoid the expense of discovery. After Kahn, it would be the rare freezeout that would not generate a lawsuit, no matter how scrupulously negotiated. The controlling shareholder might prevail, even if less than scrupulous (as the defendant eventually did in Kahn),32 but not without the risk of delay and uncertainty.33

II. TENDER OFFER/SHORT-FORM MERGER

A. The Supreme Court Shows the Shortcut to Squeezeout

Transactional planners were quick to exploit an alternative freeze-out path by combining the holdings of two more recent Delaware Supreme Court decisions: Solomon v. Pathe Communications Corp.34 and Glassman v. Unocal Exploration Corp.35 To many observers, the combined import of these two holdings threatened to vitiate the protections of the entire fairness standard as applied in Weinberger.

1. Solomon

Solomon involved an unusual takeover, in that Credit Lyonnais Banque Nederland N.V. ("the bank") was poised to gain its controlling interest not through the purchase of shares, but rather through foreclosure on an 89.5

30. Id. at 1117.
32. Kahn, 669 A.2d 79 (Del. 1995) (affirming chancery court's conclusion that merger was entirely fair to the minority despite "coercive" threats made by majority shareholder to special committee).
34. 672 A.2d 35 (Del. 1996).
35. 777 A.2d 242 (Del. 2001).
percent block of Pathe shares in which it held a security interest.\textsuperscript{36} In conjunction with this foreclosure, however, the bank proposed a tender offer for the 10.5 percent of the shares held by the public.\textsuperscript{37} Plaintiff-shareholders sought to enjoin the tender offer as both unfair and coercive.\textsuperscript{38}

The Delaware Supreme Court made short work of both claims. As to the claims of unfair price, the court curtly replied that "in the absence of coercion or disclosure violations, the adequacy of price in a voluntary tender offer cannot be an issue."\textsuperscript{39} The court also discerned no factual basis in the complaint for the allegation of coercion.\textsuperscript{40} Accordingly, it affirmed the Chancery Court's dismissal of the complaint on a 12(b)(6) motion.

2. Glassman

Glassman raised an entire fairness challenge to a merger by a controlling shareholder. It differed in one crucial respect, however, from the mergers subjected to the entire fairness standard in Weinberger, Rosenblatt, and Kahn. Unlike those cases, which involved mergers under Delaware's section 251, the merger in Glassman was to proceed under \textsection 253 of that code, the "short-form" merger provision.\textsuperscript{41} Unlike \textsection 251, which requires the approval of both the board and shareholders of the subsidiary, a merger pursuant to \textsection 253 can be implemented unilaterally by the board of the parent company if it owns at least 90 percent of the subsidiary's shares.\textsuperscript{42} It does, however, allow minority shareholders to seek appraisal under all circumstances (unlike mergers under \textsection 251, which are subject to \textsection 262's complicated "market out" provision).\textsuperscript{43}

The Glassman court found that the differences between \textsection 251 and \textsection 253 were fatal to the plaintiffs' entire fairness claim:

If a corporate fiduciary follows the truncated process authorized by \textsection 253, it will not be able to establish the fair dealing prong of entire fairness. If, instead, the corporate fiduciary sets up a negotiating committee, hires independent financial and

\textsuperscript{36} Solomon, 672 A.2d at 37.
\textsuperscript{37} Id.
\textsuperscript{38} Id.
\textsuperscript{39} Id. at 40. The chancery court had reached a similar conclusion previously in In re Ocean Drilling & Exploration Company Shareholders Litigation, 1991 WL 70028, at *3 (1991) (concluding that "as a general principle our law holds that a controlling shareholder extending an offer for minority-held shares in the controlled corporation is under no obligation, absent evidence that material information about the offer has been withheld or misrepresented or that the offer is coercive in some significant way, to offer any particular price for the minority-held stock.") and in Joseph v. Shell Oil Co., 482 A.2d 335, 343 (1984) (distinguishing Weinberger as involving a merger rather than a tender offer).
\textsuperscript{40} Id. at 40
\textsuperscript{41} Glassman, 777 A.2d at 243.
\textsuperscript{42} DEL. CODE. ANN. Tit. 8, \textsection 253.
\textsuperscript{43} Compare tit. 8, \textsection 253(d) (providing that "the stockholders of the subsidiary Delaware corporation party to the merger shall have appraisal rights as set forth in Section 262") with Del. C. \textsection 262(b) (providing various exceptions to right to appraisal for mergers under \textsection 251).
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legal experts, etc., then it will have lost the very benefit provided by the statute—a simple, fast and inexpensive process for accomplishing a merger. We resolve this conflict by giving effect to the intent of the General Assembly. In order to serve its purpose, § 253 must be construed to obviate the requirement to establish entire fairness.

The court qualified its holding by noting that the determination of fair value which would be available in an appraisal proceeding would incorporate many of the issues that would be raised in an entire fairness proceeding seeking equitable relief. It also noted that the controlling shareholder’s duty of full disclosure carried over to the short-form merger context, mandating that minority shareholders “be given all the factual information that is material to that decision.” Nonetheless, the procedural burdens imposed by Kahn were cast aside for controlling shareholders who held at least 90 percent of the subsidiary’s stock. The only requirement was full disclosure.

B. Combining Tender Offers and Short-Form Mergers

Transactional planners were quick to recognize that combining the tender offer used in Solomon with the short-form merger used in Glassman could effect a squeezeout of minority shareholders with no entire fairness review. A trio of decisions from the Chancery Court (decided by three different vice-chancellors) have blessed the two-step path to a freezeout, although they have varied in their enthusiasm.

1. Siliconix

The first case in this trilogy, In re Siliconix Inc. Shareholders Litigation, arose out of a tender offer by Vishay Intertechnology for the 19.6 percent of the Siliconix shares that it did not already own. At the time that it announced its tender offer, Vishay also disclosed that it would “consider” a follow-on short-form merger at the same price if it acquired over 90 percent of Siliconix stock. The Siliconix board responded to the tender offer by appointing a special committee (of dubious independence) to evaluate the offer of $28.82 cash per share. The special committee advised Vishay that it considered the offer inadequate. After some effort at negotiating a possible merger with the special committee, Vishay dropped its cash offer and substituted an exchange

44. Glassman, 777 A.2d at 247-48 (footnotes omitted).
45. Id. at 248.
46. Id.
47. 2001 WL 716787, at *1 (Del. Ch. 2001). Vishay had acquired its 80.4 percent stake from Daimler-Benz in 1998. Id.
48. Id. at *2.
49. The court noted that “Both members of the Special Committee had done extensive work with Vishay,” one as its attorney and the other as its banker. Id.
50. Id. at *3.
offer of one and a half shares of Vishay stock for each share of Siliconix.\textsuperscript{51} This exchange offer, unlike the previous cash offer, included no premium over the market price for Siliconix shares.\textsuperscript{52} Despite the somewhat niggardly price, the exchange offer did contain “a non-waivable ‘majority of the minority’ provision providing that Vishay would not proceed with its tender offer unless a majority of those shareholders not affiliated with Vishay tendered their shares.”\textsuperscript{53} Vishay’s exchange offer (like the earlier cash offer) did not, however, include a commitment to a follow-on short-form merger.\textsuperscript{54}

Not surprisingly, the offer provoked one of the minority shareholders to file a lawsuit seeking to enjoin the transaction. In addition to a litany of alleged disclosure violations, the plaintiff alleged that the exchange ratio did not reflect a fair price for the Siliconix shares. Following the holding in \textit{Solomon}, Vice-Chancellor Noble concluded that:

Vishay was under no duty to offer any particular price, or a “fair” price, to the minority shareholders of Siliconix unless actual coercion or disclosure violations are shown by [the plaintiff]. In short, as long as the tender offer is pursued properly, the free choice of the minority shareholders to reject the tender offer provides sufficient protection.\textsuperscript{55}

The court acknowledged the incongruity of allowing Vishay to proceed with the tender offer/short-form merger combination with minimal judicial scrutiny while a one-step freeze-out merger under § 251 would be subjected to entire fairness review, given that both paths would lead to the same result.\textsuperscript{56} The vice-chancellor offered two justifications for the differences in judicial scrutiny. First, the shareholder who rejects the tender offer would still hold his shares, even though they might be taken in the subsequent short-form merger.\textsuperscript{57} Second, the tender offer spurred no “corporate decision” as a merger would have “because the actual target of a tender is not the corporation (or its directors), but, instead, is its shareholders.”\textsuperscript{58} The bottom line is that Vishay stood on the opposite side of the transaction from the Siliconix shareholders, not the Siliconix corporation. Vishay had no control over those shareholders, who had the power to thwart the transaction by refusing to tender, so entire fairness was not triggered.\textsuperscript{59} Vishay’s only affirmative obligation as a controlling shareholder (in addition to its passive duty to avoid coercive

\textsuperscript{51.} Id. at *4.
\textsuperscript{52.} Id.
\textsuperscript{53.} Id.
\textsuperscript{54.} Id.
\textsuperscript{55.} Id. at *6.
\textsuperscript{56.} Id. at *7.
\textsuperscript{57.} Id.
\textsuperscript{58.} Id.
\textsuperscript{59.} Id. at *8 (rejecting entire fairness review because “[h]ere, the Siliconix minority shareholders have the power to thwart the tender offer because it will go forward only if a majority of the minority shares are tendered”).
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threats) was a duty of full disclosure of all material facts to the minority.\(^6^0\) The court followed precedent without additional discussion of rejecting the claim that Vishay's failure to commit to a short-form merger was actionable coercion.\(^6^1\)

The fact that the shareholders, rather than the target corporation, were called upon to make a decision also had important implications for the duties of the Siliconix board. Responding to the plaintiff's argument that the Siliconix board had a duty under *McMullin* to advise the minority shareholders on whether they should tender their shares, the vice-chancellor emphasized the lack of a statutory role for the board in tender offers which contrasted with the mandate imposed on the board under § 251 to make a recommendation to shareholders.\(^6^2\) The minority shareholders were left to their own devices in responding to Vishay's tender offer.

2. *Aquila*

*In re Aquila, Inc. Shareholders Litigation*, like *Siliconix*, involved a tender offer by an 80 percent shareholder (in this case Utilicorp) for the shares of the minority.\(^6^3\) Unlike *Siliconix*, however, Utilicorp committed to doing a short-form merger if its tender offer resulted in it obtaining 90 percent of Aquila's shares.\(^6^4\) This left the plaintiffs without a claim that the offer was coercive. Undeterred, the plaintiffs argued that they were deprived of the procedural protection of a recommendation on the tender offer by an independent board. Aquila had failed to honor its commitment made at the time of its IPO to appoint two independent directors to its five-member board.\(^6^5\) Consequently, the conflicted members of the Aquila board declined to make a recommendation on Utilicorp's offer. Instead, they solicited an analysis of the offer by an independent investment bank, which was provided to the Aquila minority.\(^6^6\) The board did not, however, request a fairness opinion from the investment bank.\(^6^7\) Following the ruling in *Siliconix*, the court concluded that the Aquila board had no obligation to provide an evaluation of the fairness of the transaction.\(^6^8\) There was little evidence that the views of independent directors would make a difference to the minority shareholders. The court

\(^{60}\) *Id.* at *9.*

\(^{61}\) *Id.* at *16.*

\(^{62}\) *Id.* at *8.*

\(^{63}\) 805 A.2d 184, 186 (Del. Ch. 2002).

\(^{64}\) *Id.* at 188.

\(^{65}\) *Id.* This commitment was required by the listing rules of the NYSE, where Aquila stock traded, and was reflected in Aquila's certificate of incorporation. *Id.* at 188 n.1 (citing N.Y.S.E. LISTED Co. MANUAL § 303.02(f)).

\(^{66}\) *Id.* at 189.

\(^{67}\) *Id.*

\(^{68}\) *Id.* at 191.
explained:
The offer being made by UtiliCorp is structured in a non-coercive way and the stockholders of Aquila appear to have adequate information and time to make an informed and reasoned decision whether or not to tender. While the presence of a functioning audit committee of independent directors might add some measure of protection for the Aquila stockholders, I cannot conclude that its absence is clear and convincing evidence of an injustice . . . even if those two new directors were to conclude that the UtiliCorp offer is unfairly priced, they could do little more than communicate their conclusion to the stockholders in the Schedule 14D-9 and recommend that they not tender . . . In the end, those stockholders would still have to decide for themselves whether to tender or not and would still have the collective power to reject the offer.69

Aquila, therefore, reaffirms Siliconix's faith in the ability of shareholders to fend for themselves.

3. Pure Resources

The smooth sailing to squeeze out validated in Siliconix and Aquila ran into rougher weather in In re Pure Resources Inc. Shareholders Litigation.70 Unlike Siliconix and Aquila, in which the courts were content to allow the tender offers to proceed with minimal scrutiny, Vice-Chancellor Leo Strine held forth at length on a variety of topics in Delaware corporate law that he considered relevant to the legality of tender offers by controlling shareholders. In the end, however, he somewhat grudgingly allowed the offer to proceed subject to only minor modifications.

The offer under review was Unocal's exchange offer for the 35 percent of Pure Resources' shares that it did not already own.71 Like the Siliconix and Aquila offers, Unocal conditioned its offer on approval by a majority of the minority.72 And like the offer in Aquila, Unocal committed itself to a short-form merger at the same price if it obtained 90 percent of Pure Resources' shares.73 The facts alleged in Pure Resources differed from Siliconix and Aquila in two important aspects: (1) the Pure Resources management was generally hostile to Unocal's bid; and (2) the Pure Resources board appointed an energetic special committee that gave Unocal's offer a very hard look.

Pure Resources had been formed as the result of the combination of Unocal's oil and gas operations in the Permian Basin (located in western Texas and southeastern New Mexico) with Titan Exploration, an independent oil and gas company operating in the same area.74 Titan's managers stayed on to run

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69. Id. at 194.
70. 808 A.2d 421 (Del. Ch. 2002).
71. Id. at 425.
72. Id. at 430.
73. Id.
74. Id. at 425.
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Pure Resources, but the relationship between Unocal and Pure Resources’ management proved to be prickly.\textsuperscript{75} More importantly, in the context of Unocal’s tender offer, management held a quarter of the Pure Resources’ shares not owned by Unocal.\textsuperscript{76} Consequently, Unocal’s tender offer faced tough sledding if it did not appeal to this bloc.\textsuperscript{77} Moreover, it is difficult to imagine that Unocal had any informational advantage over Pure Resources’ management in pricing Pure Resources’ stock—a recurring worry in tender offers by controlling shareholders. Therefore, the presence of a hostile management bloc made Pure Resources an unlikely case for raising concerns about a “coerced” minority.

Minority shareholders could take further comfort from the fact that the special committee appointed by Pure Resources was not content to merely roll over in the face of Unocal’s offer. Instead, the special committee sought “the full authority of the board under Delaware law to respond to the offer.”\textsuperscript{78} Such authority would have provided the committee not only the power to negotiate, but also would have added teeth to its negotiating position: the full authority of the board would presumably include the ability to adopt a poison pill and to thwart Unocal’s offer.\textsuperscript{79} The full board (including the Unocal designees on the board) rebuffed this request by the special committee. Despite this limitation on the authority, the special committee attempted to extract a higher price from Unocal, but to no avail.\textsuperscript{80} In the face of Unocal’s recalcitrance, the special committee voted to recommend against Unocal’s offer; this recommendation was conveyed to Pure Resources’ shareholders in the company’s Schedule 14D-9.\textsuperscript{81}

The special committee’s recommendation against tendering into the offer did not satisfy the plaintiff-minority shareholder, who sought to enjoin the tender offer from proceeding. Given the factual similarities to Siliconix and Aquila, those precedents would have provided a relatively straightforward basis for refusing the injunction. Vice-Chancellor Strine, however, seized the opportunity provided by the proceeding to hold forth on a wide-ranging series of issues in Delaware takeover law. The duty of judges, as the vice-chancellor saw it, was to craft “equitable principles sufficient to protect against abuse and unfairness, but not so rigid as to stifle useful transactions that could increase the shareholder and societal wealth generated by the corporate form.”\textsuperscript{82} A lofty

\begin{itemize}
\item \textsuperscript{75} Id. at 427.
\item \textsuperscript{76} Id. at 425.
\item \textsuperscript{77} At the time of the lawsuit, management had announced that it did not intend to tender its shares.
\item \textsuperscript{78} Id. at 452.
\item \textsuperscript{79} Id. at 430.
\item \textsuperscript{80} Id. at 432.
\item \textsuperscript{81} Id.
\item \textsuperscript{82} Id. at 434.
\end{itemize}
goal, indeed.

Strine was troubled by the "possible incoherence" in treating "economically similar transactions as categorically different simply because the method by which controlling stockholder proceeds varies." 83 Minority shareholders were just as squeezed out after tender offers followed by short-form mergers under § 253 as they were after mergers between subsidiaries and controlling shareholders under § 251. So why treat the transactions differently? Worse yet, the judge felt the threat to minority shareholders was arguably greater in the tender offer/short form merger transaction. The vice-chancellor remarked:

In a merger vote, stockholders can vote no and still receive the transactional consideration if the merger prevails. In a tender offer, however, a non-tendering shareholder individually faces an uncertain fate. That stockholder could be one of the few who holds out, leaving herself in an even more thinly traded stock with little hope of liquidity and subject to a § 253 merger at a lower price, or at the same price but at a later (and, given the time value of money, a less valuable) time. The 14D-9 warned Pure's minority shareholders of just this possibility. For these reasons, some view tender offers as creating a prisoner's dilemma - distorting choice and creating incentives for stockholders to tender into offers that they believe are inadequate in order to avoid a worse fate. 84

Thus, the specter of coercion made the shareholders' decision to tender their shares suspect as an indicia of the fairness of the offer.

Strine was also troubled by another disparity in Delaware's corporate law: tender offers by controlling shareholders were subject to relatively hands-off treatment, while tender offers by third parties justified the invocation by target boards of the full gamut of corporate defenses. 85 This issue had heightened salience in Pure Resources in light of the special committee's rebuffed efforts to be delegated authority to adopt a poison pill. Despite the lack of a statutory role for boards of directors in responding to tender offers, the Delaware Supreme Court had recognized an "affirmative duty" for directors of companies confronted with tender offers. 86 Strine focused on this language from that court's seminal decision validating defensive measures against hostile takeovers, Unocal Corp. v. Mesa Petroleum Co.:

[T]he board's power to act derives from its fundamental duty and obligation to protect the corporate enterprise, which includes stockholders, from harm reasonably perceived, irrespective of its source. Thus, we are satisfied that in the broad context of corporate governance, including issues of fundamental corporate change, a board of directors is not a passive instrumentality. 87

83. Id. at 435.
84. Id. at 441-42.
85. Id. at 444 ("As a general matter, Delaware law permits directors substantial leeway to block the access of stockholders to receive substantial premium tender offers made by third-parties by use of the poison pill but provides relatively free access to minority stockholders to accept buy-out offers from controlling stockholders.").
86. Id. at 440.
87. Id. (quoting Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985)) (emphasis Strine's).
Tender Offers by Controlling Shareholders

Why then, should the board of a controlled subsidiary be a "passive instrumentality" when confronted by a tender offer from the controlling shareholder, the position seemingly endorsed by Siliconix and Aquila? Did the undiluted fiduciary duty of a subsidiary’s board require the directors to adopt a poison pill to give minority shareholders’ bargaining leverage in the face of a tender offer by a controlling shareholder? On the one hand, such a mandate would have given minority shareholders the ability to extract higher prices in freezeouts. On the other, it would have gutted the advantages of the tender offer/short-form merger path to squeeze out for controlling shareholders. Controlling shareholders might hesitate to make such offers as a consequence, and ex ante, reluctant to become controlling shareholders at all.

The plaintiffs squarely put this issue to the court. They argued that the Pure Resources board’s rejection of the special committee’s request for the authority to adopt a poison pill was subject to the entire fairness standard because Unocal controlled the board. The court declined the plaintiffs’ invitation, despite what it termed the “analytical and normative appeal, embodying as it does the rough fairness of the goose and gander rule.” The court’s rationale, however, was somewhat tenuous: it was “reluctant . . . to burden the common law of corporations with a new rule that would tend to compel the use of a device that our statutory law only obliquely sanctions and that in other contexts is subject to misuse, especially when used to block a high value bid that is not structurally coercive.” The court’s reluctance stemmed from the “awkwardness of a legal rule requiring a board to take aggressive action against a structurally non-coercive offer by the controlling stockholder that elects it.”

"Awkwardness" is less than compelling as a justification for avoiding the protections of entire fairness. Moreover, it is difficult to characterize the Delaware Supreme Court’s treatment of defensive measures as only obliquely sanctioning them, though the attitudes of some members of the court of chancery may be less favorable. The vice-chancellor’s distinction of Digex, in which the subsidiary board was held to have breached its fiduciary duty by waiving the anti-takeover protections of § 203, is similarly shaky. According

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88. Id. at 443 (noting "an . . . obvious concern is that subsidiary directors might use the absence of a statutory role for them in the tender offer process to be less than aggressive in protecting minority interests, to wit, the edifying examples of subsidiary directors courageously taking no position on the merits of offers by a controlling stockholder").
89. Cf. Weinberger v. UOP, Inc. 457 A.2d 717, 710 (Del. 1983) ("There is no dilution [of the obligation of fiduciary duty] where one holds dual or multiple directorships, as in a parent-subsidiary context. Thus, individuals who act in a dual capacity as directors of two corporations, one of whom is parent and the other subsidiary, owe the same duty of good management to both corporations . . . .")
91. Id.
92. Id.
93. Id.
to the court, in *Digex* "the controlling stockholder forced the subsidiary board to take action only beneficial to it, whereas here the Pure board simply did not interpose itself between Unocal’s offer and the Pure minority." This rationale rings a bit hollow in light of the fact that the special committee had attempted to interpose itself, but was rebuffed by the Unocal-dominated board. Was not the refusal of the Pure Resources board to give the special committee authority to adopt the poison pill "action only beneficial to" Unocal? Overall, the court’s rejection of the entire fairness argument put forth by the plaintiffs is a bit thin.

Perhaps a more candid (but no more intellectually satisfying) response to the plaintiffs’ argument would have been the constraint on a lower court of the combined import of the Delaware Supreme Court’s decisions in *Solomon* and *Glassman*. While those cases are not squarely controlling on this point, a lower court could be forgiven for reading the direction that the wind was blowing in the court above. The “just say no” authority to thwart the advances of a controlling shareholder sought by the special committee in *Pure Resources* is the benchmark of fair dealing under *Kahn*, and *Solomon* and *Glassman* are clearly a turn away from that regime.

Rather than risk reversal, the *Pure Resources* court endeavored to satisfy its concerns within the “non-coercive” doctrinal framework established by *Solomon*. Vice-Chancellor Strine imposed three requirements intended to ensure that the tender offer was non-coercive:

1) a non-waivable majority of the minority tender condition;
2) the controlling stockholder promises to consummate a prompt § 253 merger at the same price if it obtains more than 90 percent of the shares; and
3) the controlling stockholder has made no retributive threats.

Applying these principles to the case at hand, the court found that Unocal had failed the first prong by failing to exclude Pure Resources’ management from the definition of the minority and enjoined the offer until it was revised.

### 4. The Definition of Non-Coercion

The last of the *Pure Resources* requirements is an uncontroversial criterion for non-coercion, but the first two are less obvious. The first objection to them is obvious: both of these protections could be provided contractually, so should judges supply them when parties do not?

A contractarian answer has appeal in this setting. Consider how minority shareholders got to be minority shareholders. There are two primary avenues.

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95. *Pure Resources*, 808 A.2d at 446 n.49 (citing *Digex*, 789 A.2d 1176 (Del. Ch. 2000)).
96. *Kahn v. Lynch Communication Systems, Inc.*, 638 A.2d 1110, 1119-20 (Del. 1994) (emphasizing that special committee negotiating a merger with a controlling shareholder must have “power to say no”).
97. *Pure Resources*, 808 A.2d at 445.
98. *Id.* at 446-47.
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The first is a public offering by a parent company doing an equity carveout of a subsidiary. It does not take a zealous faith in the efficient capital market hypothesis to see that the risks of appropriation by the controlling shareholder will lead investors to discount the value of shares in a company that has a dominant shareholder. This discount, of course, comes out of the pocket of the controlling shareholder, who will receive less for the shares that it sells in the public offering. If the discount is too great, the controlling shareholder will take steps to reduce discounting by ensuring minority shareholders receive adequate protection in the event of a subsequent freezeout. Such a risk is surely obvious enough that investors will take it into account in valuing the securities.

The second principal path to becoming a minority shareholder is as a result of a third-party tender offer for a majority, but less than all, of the shares. The target board, armed with the bargaining leverage of the poison pill, surely has a role to play in securing protections for shareholders whose stock will not be taken up in the tender offer. Extracting procedural protections for those soon-to-be minority shareholders is entirely consistent with the target board’s Revlon duties. In the post-Solomon/Glassman world, directors of target boards would do well to take such concerns into account when negotiating with potential acquirors. Alternatively, the board can insist on a higher premium from acquirers seeking less than any and all shares. All of the shareholders would be entitled to share in that initial premium on a pro rata basis.

Even if one thinks that judges should play a more active role in protecting shareholders who (or whose bargaining agents) have neglected to protect themselves, the Pure Resources non-coercive criteria seem less than compelling. The requirement of a majority of the minority seems largely superfluous—why would a controlling shareholder offer an amount less than what it would expect to produce a majority of the minority’s shares? The tender offer itself is not free, and simply increasing its percentage ownership of the company offers few benefits to a controlling shareholder. Only if it reaches the magic number of 90 percent will there be a concrete benefit, i.e., the ability to do a short-form merger and take the company private, which should generate cost savings. The controlling shareholders in Siliconix and Aquila each owned 80 percent of the shares—they needed a majority of the minority to get the 90 percent needed to do the short-form merger. A majority of the minority would have done little for Unocal—it needed slightly more than 71 percent of the 35 percent of the Pure Resources stock that it did not already own to reach the crucial 90 percent threshold.

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99. See Paramount Communications v. QVC Network, 637 A.2d 34 (Del. 1994) (suggesting that a poison pill could be used to extract protections for soon-to-be minority shareholders).
100. It is possible, one supposes, to acquire a controlling bloc through open-market transactions. The poison pill, however, would appear an insuperable barrier to this takeover strategy.
101. See Donald J. Wolfe, Jr., The Odd Couple: Majority of Minority Approval and the Tender
As a strategic matter, any offer that does not include a condition that the offeror obtain 90 percent of the shares sends a strong signal that the offeror believes that there is a good chance that it will be rebuffed, i.e., it is a low-ball offer. An investor does not need to be an investment professional to recognize that an offer lacking such a condition should be rejected. To be sure, some firms will hold closer to 90 percent and may be able to proceed with less than a majority of the minority; but those firms are likely to find it cheaper to buy what they need in open-market transactions, so even the Pure Resources criteria would be inapplicable.

This line of analysis also suggests that the requirement of a commitment to do a § 253 merger is also redundant. Moreover, other courts have not seen that as necessary to ensure non-coercion. Recall that the controlling shareholder did not commit to a § 253 merger in Siliconix, but the court there did not conclude that made the offer coercive. For that matter, the controlling shareholder did not commit to a follow-on merger in Solomon, although the issue is not discussed by the court. The shares of the subsidiary left outstanding were subsequently delisted by the NYSE. The failure to follow up the tender offer with a merger will undoubtedly cause the shares to lose value (particularly if they are delisted), but it does not follow that it makes the tender offer coercive. Will the diminution be sufficient to cause a shareholder to tender into an undervalued offer? They will, after all, continue to hold their shares and have a pro rata claim on any earnings distribution. Is that claim worth more or less than a low-ball offer by the controlling shareholder? These are, however, largely quibbles. Controlling shareholders will not be burdened unduly by the Pure Resources criteria in most cases. The bottom line for transactional planners is that the tender offer/short-form merger combination provides a ready means for evading the entire fairness regime imposed on controlling shareholders doing mergers under § 251.

III. OBJECTIONS

The Solomon/Glassman circumvention of the entire fairness standard has obvious procedural benefits and cost savings, but it has, nonetheless, provoked the usual outpouring of complaints about the potential for its abuse. Those

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Offer, 6 M & A LAWYER 6 n.26 (2002) (majority of minority provision was “intended solely for the benefit of the controlling stockholder itself to ensure ultimate ownership of at least 90% of the outstanding shares and the attending capacity to effect a short form merger without further fuss or ado. This condition was labeled a majority of the minority approval condition rather than a minimum shares condition by a clever lawyer seeking, successfully it would appear, to suggest an equitable motive for an otherwise obviously self serving provision”).


complaints fit generally into two categories echoing the concerns expressed by Vice-Chancellor Strine in *Pure Resources*: coercion and fair price. I deal with each of these objections in turn.

A. Coercion

The most frequent complaint about *Solomon/Glassman* and their progeny is that the standards set forth by the Delaware courts for tender offers for controlling shareholders will not protect investors from coercion. This specter of coercion, it is said, removes any assurance that the acceptance by minority shareholders of the tender offer reliably indicates that they consider the price to be reasonable. Shareholders will tender even at lowball prices, the argument goes, rather than face an uncertain future as a minority shareholder of a still smaller minority, facing possible delisting with its attendant loss of liquidity. Even if the controlling shareholder proceeds with a § 253 merger, it will come at later time and, potentially, a lower price. For those declining the merger price, opting for appraisal ensures even more uncertainty and delay.

Some commentators go further, claiming that all tender offers are coercive. The claim that even a fully-informed minority can be coerced into accepting offers by controlling shareholders certainly has a theoretical appeal to those inclined to find oppression at every turn. Unfortunately, it runs afoul of empirical reality: minority shareholders are not readily buffaloed into accepting a lowball offer. Consider the tender offers in the cases discussed above. Vishay won its battle in court, but lost the war when less than a majority of the Siliconix minority shareholders tendered their shares. Siliconix continues as a public company today. Unocal succeeded with its tender offer for Pure Resources, but only after offering a more generous exchange ratio to the Pure Resources minority, which induced the Pure Resources board (and management) to recommend the offer. At the time Unocal raised its offer, only 450,404 shares had been tendered, representing 2.6 percent of the shares.

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104. See, e.g., Kimble C. Cannon, *Augmenting the Duties of Directors to Protect Minority Shareholders in the Context of Going-Private Transactions: The Case for Obligating Directors to Express a Valuation Opinion in Unilateral Tender Offers after Siliconix, Aquila and Pure Resources*, 2003 COLUM. BUS. L. REV. 191, 196-7 ("[T]he line of Delaware cases permitting director inaction in connection with unilateral tender offers also legitimizes as non-coercive a class of tender offer transaction that leaves shareholders no practical choice but to accept an offer's terms.").

105. Id. at 242.


held by the minority.\textsuperscript{111} Apparently the 97.4 percent that held out for a better offer did not understand that they had no choice but to tender. Only in the third case of the trilogy—Aquila—did the controlling shareholder succeed with its tender offer without raising its bid.\textsuperscript{112} Other controlling shareholders have faced similar resistance.\textsuperscript{113} In the choices that we commonly think of as coercive—"Your money or your life"—a considerably lower percentage dare to risk the imposition of the coercive sanction.

What do these investors know that lawyers and law professors do not? Perhaps it is that the "coercive" threat posed by controlling shareholder tender offers is not much of a threat. To begin, the threat of being left behind as a member of a smaller minority is largely illusory—Utilicorp and Unocal announced short-form mergers immediately upon acquiring 90 percent of Aquila and Pure Resources.\textsuperscript{114} As noted above, raising your controlling stake above 90 percent only makes sense if you plan to proceed promptly with the squeezeout. Otherwise you are giving up a relatively cheap source of capital and increasing risk for a very limited return. Moreover, the Delaware appraisal statute gives a strong incentive to complete the merger promptly. Under Cede & Co. v. Technicolor, Inc.,\textsuperscript{116} minority shareholders are entitled to any post-tender offer increases in the value of the company. Controlling shareholders who delay a short-form merger will be required to share the value of any changes they make in the subsidiary's operations. Furthermore, only controlling shareholders who believe that the subsidiary's value will increase have an incentive to make an offer at all. Thus, waiting to complete the short-form merger will increase the prospect that the minority shareholders will seek appraisal. The controlling shareholder would prefer to avoid having any shareholders seek that remedy because of the expense and distraction of having to defend in the appraisal proceeding. It is the litigation costs, rather than the risk of a higher payout to a small minority, that provide appraisal with its real deterrent value—and give corresponding credibility to the threat of minority shareholders not tendering.

This line of reasoning also suggests why a lower offer in the short-form


\textsuperscript{112.} See Utilicorp Completes Aquila Merger, POWER MARKETS WEEK, Jan. 14, 2002, at 15.

\textsuperscript{113.} See, e.g., Tyson Freeman, \textit{Son of Siliconix}, CORP. CONTROL ALERT, Oct. 23, 2002, (reporting that Network Associates tender offer for McAfee yielded only 4 percent of outstanding shares after Network Associates had raised bid five times; sixth bid resulted in endorsement by McAfee independent directors and success of tender offer); Reuters, \textit{Motorola increases its bid for Next Level; Companies agree on $1.18 per share}, CHICAGO TRIBUNE, Mar. 25, 2003, at C3, (reporting that Motorola was forced to increase its bid after tenders under original offer did not meet minimum condition).


\textsuperscript{115.} See supra Part II.B.4.

\textsuperscript{116.} 684 A.2d 289 (Del. 1996).
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merger following the tender offer is exceedingly unlikely. What could be more of a red flag to a minority shareholder considering his or her appraisal option?

Apart from these rather tenuous implicit threats, if the controlling shareholder makes an actual threat to induce the minority to tender, or a structurally coercive offer, those threats are actionable coercion under Solomon. And virtually all such threats will be litigated because they are necessarily conspicuous—the threat is ineffective if the public shareholders are not made aware of it. In sum, the specter of coercion is just that, a specter.

B. Fair Price

Commentators have also complained that the Solomon/Glassman regime deprives minority shareholders of the bargaining leverage afforded by the entire fairness regime. Only a special committee of independent directors with the power to “say no” will ensure that minority shareholders get the best price for their shares.

One would question, however, whether the best price is the fair price for minority shareholders. Wealth transfers in this essentially self-contained, multi-period bilateral negotiation between majority and minority hardly present a compelling case for legal intervention. As noted above, minority shareholders generally did not acquire their minority status by accident. They invested in a public offering by a controlling shareholder, in which case the risk of “unfair” expropriation was incorporated into the price that they paid for their shares. Alternatively, they had the opportunity to sell their shares pro rata into a tender offer by which the controlling shareholder obtained control, in which case they shared in the control premium paid by the controlling shareholder. Should the controlling shareholder have to pay a second control premium, in this case a “complete control” premium?

Such a regime would reduce the number of transactions seeking control, a result unlikely to benefit investors ex ante. Remember that minority shareholders are not discrete and insular minorities: the minority shareholder of the subsidiary may well be part of a diffuse public majority of the parent corporation. Certainly, if they hold a diversified portfolio, they can expect to be

117. See Jon E. Abramczyk et al., Going-Private “Dilemma”?—Not in Delaware, 58 BUS. LAW. 1351, 1363 (2003) (“[T]he court’s insistence that there be no threat of retribution reaffirms the longstanding practice of Delaware courts to scrutinize carefully whether there is any actionable coercion in tender offers made by controlling stockholders.”).


119. See Resnick, supra note 118 at 261 (arguing that “adequate procedures are important to ensuring that minority shareholders get the best price, not just a fair price”).

120. See supra Part II.
on the parent side as often as the subsidiary side. If this is the case, requiring subsidiary boards to extract the largest possible premium would simply create greater transaction costs, with minimal benefits for public shareholders.\textsuperscript{121}

This argument, however, may prove too much—investors are just as likely to be shareholders in acquiring corporations as they are target corporations, but that has not kept the Delaware Supreme Court from approving a regime of defensive measures that allows target company boards to extract all of the available rents from hostile acquirers. The court has specifically rejected a model of director passivity in response to outside tender offers.\textsuperscript{122} Indeed, Revlon essentially mandates that a target board which has made the decision to sell must extract every last dollar for its shareholders.\textsuperscript{123} Why not expect as much from the boards of controlled corporations?

The analogy to Delaware’s regime for third-party tender offers is central to Ron Gilson and Jeff Gordon’s criticism of the Solomon/Glassman regime. Like Vice-Chancellor Strine, they seize upon the language in Unocal suggesting that target directors have “both the power and duty to oppose a bid it perceived to be harmful to the corporate enterprise.”\textsuperscript{124} This “power and duty” subsequently was held to include the power to adopt a poison pill in Moran v. Household International.\textsuperscript{125} In Gilson and Gordon’s view, the target board passivity approved in Siliconix, Aquila, and Pure Resources raises a “troubling inconsistency in Delaware law: that minority shareholders of a controlled company receive less protection when faced with a hostile ‘internal’ tender offer than shareholders faced with a hostile ‘external’ tender offer.”\textsuperscript{126} Gilson and Gordon claim that if target directors “have the right to prevent the shareholders from choosing to accept a hostile tender offer by declining to redeem a pill, there is no coherent case for not demanding that target directors confronting a freeze-out tender offer have available the same power.”\textsuperscript{127}

Gilson and Gordon’s claim turns on whether the duty to rebuff hostile tender offers recognized in Unocal sweeps as broadly as the power also recognized there and expanded in subsequent cases. I have my doubts. Recall that the offer rebuffed in Unocal involved two-tiered consideration, with cash

\textsuperscript{121} See Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 209 (1991) (“Courts shape the corporate contract, and legal rules influence the wealth of investors who may hold stock in bidders, targets, bystanders, or (most likely) all three groups. Robbing Peter to pay Paul is poor use of corporate law, especially when Peter is just Paul’s nom de plume.”).

\textsuperscript{122} Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 n.10 (Del. 1985) (observing that Easterbrook and Fischel’s argument for passivity “clearly is not the law of Delaware”).


\textsuperscript{124} Gilson & Gordon, supra note 118, at 38 (quoting Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 949 (Del. 1985) (emphasis supplied by Gilson & Gordon)).

\textsuperscript{125} 500 A.2d 1346 (Del. 1985).

\textsuperscript{126} Gilson & Gordon, supra note 118, at 55.

\textsuperscript{127} Id. at 59.
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at the front end and highly subordinated securities at the back end. The coercion in such an offer is apparent: tender and get the cash, or refuse, and risk getting the junk bonds instead. As such, it was what the Delaware Supreme Court would later come to term "structurally coercive."

The modifier "structurally" was necessary to distinguish a second category of threat that the target board had the power to defend against: "substantive coercion." Substantive coercion describes "the risk that shareholders will mistakenly accept an underpriced offer because they disbelieve management's representations of intrinsic value." Although the coercion in "structural coercion" is fairly clear (making the case for judicial intervention correspondingly straightforward), the use of the word coercion in connection with the price offered in a voluntary tender offer for shares is at least odd, and, some might say, an abuse of the English language. Most observers would agree that the risk of erroneous shareholder tendering is slight, particularly if the target directors are afforded an opportunity to explain why the unwelcome offer does not reflect the target's intrinsic value. Investors, particularly the institutional investors who are likely to hold the balance of power in most takeover battles, are not in the business of throwing money away. Greed is a powerful incentive to see things clearly. There may be a threat here, but it scarcely rises to the level of coercion—perhaps "confusion," at most.

Surely, the members of the Delaware Supreme Court know this, despite the rhetoric of "substantive coercion." Gilson and Gordon are correct that there appears to be a "sharp disconnect" between Solomon's affirmation of the shareholders' right to consider tender offers by controlling shareholders, as long as they are not infected by "actionable coercion" and the rhetoric of "substantive coercion" employed in the court's review of anti-takeover

128. Unocal, 493 A.2d 946, 949. The court also cited the risk of two-tier tender offers when it subsequently approved the use of poison pills as a defensive measure. See Moran v. Household International, Inc., 500 A.2d 1346, 1356 (Del. 1985) ("Household has adequately demonstrated, as explained above, that the adoption of the Rights Plan was in reaction to what it perceived to be the threat in the market place of coercive two-tier tender offers.").


130. Id.

131. A Delaware chancellor, for example, stated:

[O]ne of corporate management's functions is to ensure that the market recognizes the value of the company and that the stockholders are apprised of relevant information about the company. This informational responsibility would include, one would think, the duty to communicate the company's strategic plans and prospects to stockholders as clearly and understandably as possible. If management claims that its communication efforts have been unsuccessful, shouldn't it have to show that its efforts were adequate before using the risk of confusion as a reason to deny its stockholders access to a bid offering a substantial premium to the company's market price?

defenses. However, the Delaware Supreme Court may treat these seemingly similarly situated shareholders differently because the two contexts raise distinct policy concerns. Perhaps the threat of "substantive coercion" is not really a threat to shareholders, but instead, to another constituency entirely.

To see what might be at work, we need to look past the rhetoric of the court's anti-takeover jurisprudence to the substance of the rules that it actually applies. Specifically, what are the limits of the board's power to hide behind a poison pill and thereby preclude shareholder consideration of a third-party tender offer? After wading through a lot of cases, we find two situations in which the pill must be redeemed: 1) when the company has put itself up for sale, thereby invoking Revlon duties, and 2) when an insurgent has prevailed in a proxy battle to replace the incumbent board that has been resisting. Outside these two areas, the target board's power to resist an offer is subject only to Unocal's proportionality review, which is to say, essentially unconstrained.

The board can "just say no" to an unwanted takeover. Looking at these rules as applied, rather than taking judicial rhetoric at face value, may give us a better sense of the actual policy concerns in play.

Recognizing when a board has put a company up for sale, and thus subjected the directors' conduct to the exacting scrutiny of the Revlon standard, is not simple. Is a company for sale when it agrees to merge with another company? The answer to this question, we found out in Time-Warner, is generally no. The triggering event for the Revlon duty to maximize value for shareholders became clear in QVC: a change in control of the corporation. Why is control the central focus?

When a majority of a corporation's voting shares are acquired by a single person or entity, or by a cohesive group acting together, there is a significant diminution in the voting power of those who thereby become minority shareholders. In the absence of devices protecting the minority stockholders, stockholder votes are likely to become mere formalities where there is a majority stockholder. For example, minority stockholders can be deprived of a continuing equity interest in their corporation by means of a cash-out merger. Absent effective protective provisions, minority stockholders must rely for protection solely on the fiduciary duties owed to them by the directors and the majority stockholder, since the minority stockholders have lost the power to influence corporate direction through the ballot. The acquisition of majority status and the consequent privilege of exerting the powers of majority ownership come at a price. That price is usually a...
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control premium which recognizes not only the value of a control block of shares, but also compensates the minority stockholders for their resulting loss of voting power.\(^{136}\)

Control can be sold, but a price must be paid to compensate the shareholders for the voting authority that they are yielding when they consent to the transaction. The transfer of control—and the fiduciary obligations that accompany it—is tied to the power conferred by the shareholder vote.

Less obvious, but of equal importance, the question of control is inextricably intertwined with the protections of the business judgment rule for directors. If control is to change hands, the target company directors’ business judgment is entitled to considerably less deference. The \textit{QVC} court explained: “Irrespective of the present Paramount Board’s visions of a long-term strategic alliance with Viacom, the proposed sale of control would provide the new controlling stockholder with the power to alter that vision.”\(^{137}\) The business judgment rule preserves the discretion of the directors to take risks in making business decisions against the threat of second guessing by judges. Defenses against takeover are tools to protect the business judgment of the directors from second guessing by market participants. When the board has ceded the authority to implement its judgment, however, it loses the protection of the business judgment rule.\(^{138}\) Once the board has conceded that it is no longer the best custodian of the corporation’s assets, the board has a duty to extract the best price for the public shareholders who will be giving up control.

The other takeover context in which the board can also lose the protection of the business judgment rule is when its defense against a takeover conflicts with the shareholders’ exercise of their franchise. Under the \textit{Blasius} standard, the business judgment rule gives way when board discretion conflicts with the shareholder’s vote because “[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests.”\(^{139}\) By contrast, defensive measures adopted with shareholder approval are not subjected to any form of enhanced scrutiny, even the toothless \textit{Unocal} variety.\(^{140}\)

These rules are not purely the product of common-law evolution; statutory rules are fundamental here. Director primacy over the corporation’s direction is

\(^{136}\) Id. at 42.

\(^{137}\) Id. at 43.

\(^{138}\) From this perspective, the \textit{QVC} rule has a similar import to the rule of Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985), which denied the protections of the business judgment rule to directors who had made an uninformed judgment.


\(^{140}\) \textit{Williams} v. Geier, 671 A.2d 1368, 1377 (Del. 1996) (“A \textit{Unocal} analysis should be used only when a board unilaterally (i.e., without stockholder approval) adopts a defensive measure in reaction to a perceived threat.”).
mandated by § 141(a), which directs that the corporation's business and affairs "shall be managed by or under the direction of a board of directors." That power, however, is subject to the shareholder's overarching authority to replace the board through the electoral process, as recognized in § 141(k).

This quick overview hardly does justice to the nuances of Delaware's antitakeover jurisprudence, but for the purposes of this Article, it is the broad principles that count. As a descriptive matter, the interrelated pieces of the Delaware Supreme Court's antitakeover jurisprudence can perhaps best be seen as maintaining director supremacy over the business and affairs of the corporation. Directors call the shots, limited only by the shareholders' ability to select who the directors will be: if the shareholders are unhappy with the job that the directors are doing, they can throw the bums out, but only through the electoral process. One can quarrel with the wisdom of this policy choice favoring proxy fights over tender offers (perhaps one should put more faith in the ability of investors to balance short-term gains against long-term ones), but director supremacy constrained by electoral accountability seems to reflect the actual practice of the Delaware Supreme Court in deciding cases. Furthermore, one cannot dismiss the theory underlying this director supremacy model as simply foolish. For better or worse, the Delaware Supreme Court's Unocal doctrine allows directors to protect themselves against second-guessing of their business judgment by the marketplace.

141. DEL. CODE ANN. tit. 8, § 141(a). See also Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) ("Under Delaware law, the business judgment rule is the offspring of the fundamental principle, codified in 8 Del. C. § 141(a), that the business and affairs of a Delaware corporation are managed by or under its board of directors.").

142. DEL. CODE ANN. tit. 8, § 141(k) ("Any director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors . . .").


144. One Delaware court elaborated:

Maintaining proper balance in the allocation of power between the stockholders' right to elect directors and the board of directors' right to manage the corporation is dependent upon the stockholders' unimpeded right to vote effectively in an election of directors. This Court has repeatedly stated that, if the stockholders are not satisfied with the management or actions of their elected representatives on the board of directors, the power of corporate democracy is available to the stockholders to replace the incumbent directors when they stand for reelection.


145. See, e.g., Lucian A. Bebchuk, The Case Against Board Veto in Corporate Takeovers, 69 U. CHI. L. REV. 975, 977-81 (2002) (arguing that boards should not be permitted to block noncoercive offers); Ronald J. Gilson, Unocal Fifteen Years Later (And What We Can Do About It), 26 DEL. J. CORP. L. 491, 507-09 (2001) (arguing that the shareholders should decide whether to accept or reject a bid for control).

146. See Marcel Kahan & Edward B. Rock, How I Learned to Stop Worrying and Love the Pill: Adaptive Response to Takeover Law, 69 U. CHI. L. REV. 871 (2002); Martin Lipton, Pills, Polls, and Professors Redux, 69 U. CHI. L. REV. 1037, 1064-66 (2002) (arguing that the decision whether to accept or reject an acquisition offer was primarily for the board of directors).
Tender Offers by Controlling Shareholders

How do these broad principles apply to tender offers by controlling shareholders? Can one reconcile the seeming conflict between the passive role for the board endorsed in *Solomon* and the active auctioneering role mandated by *Revlon* (as more fully explicated by *QVC*)? The focus on control provides the key. Control will not shift as a result of a tender offer by the controlling shareholder; the controlling shareholder will enjoy the same level of authority over the corporate enterprise whether the offer succeeds or fails. Consequently, there is no threat to the business judgment of the board—the board’s business judgment is already subject to the overarching authority of the controlling shareholder. The board has no duty to extract a premium because control has already shifted (through the earlier tender offer by which the controlling shareholder gained control) or was never yielded (because it was retained at the IPO stage). In addition, interference with the shareholder franchise is not implicated because the power reflected by that franchise is held—quite lawfully—by the controlling shareholder. The board of the controlled subsidiary has no duty to adopt a poison pill because there is no threat to the control of the subsidiary.

Gordon and Gilson counter by asking “why should the board’s duty to protect shareholders be lower when the threat is the misuse of control than when the threat is an unfavorable transfer of control?” Characterizing the controlling shareholder’s efforts to freeze out the minority as “misuse,” however, begs the question. Simply put, controlling shareholders have rights too. Controlling shareholders owe the corporation a fiduciary duty, but that duty does not require self-sacrifice. Anyone can make an offer for the shares held by the minority, so why should a controlling shareholder be disabled from doing the same? The corporate machinery is not implicated. More to the point, if the shareholders of a company that is owned by a diffuse public majority have the power to replace the board of directors with one that will redeem the pill, why should a controlling shareholder be disabled from doing the same?

The board has limited authority to interfere with the prerogatives of a controlling shareholder. According to Chancellor Allen:

> The board’s fiduciary obligation to the corporation and its shareholders, in this setting, requires it to be a protective guardian of the rightful interest of the public shareholders. But while obligation may authorize the board to take extraordinary steps to protect the minority from plain overreaching, it does not authorize the board to deploy corporate power against the majority stockholders, in the absence of a threatened serious breach of fiduciary duty by the controlling stockholder.

148. Mendel v. Carroll, 651 A.2d 297, 307 (Del. Ch. 1994) (stating that issue of option that would have diluted majority stockholder’s interest would have breached board’s fiduciary duty to controlling stockholder).
150. Mendel, 651 A.2d at 306. See also Freedman v. Restaurant Associates Industries, 1987 WL 14323, at *9 (Del. Ch. 1987) (“I take it to be established in our law that it would ordinarily be found to
The controlling shareholder is within its rights in vetoing the sale of the subsidiary to a third party, and no one thinks that this veto is subject to entire fairness review. The tender offer does not require the minority shareholders to give up any entitlement (they are free to—and they do—decline to tender). The possibility of a follow-on short-form merger is explicitly authorized by statute. Consequently, it would be odd to characterize either step of the transaction as misuse, much less the "serious breach of fiduciary duty by the controlling stockholder required to justify action against the controlling shareholder." Thus, the only apparent "threat" here is that the minority shareholders will be unable to extract a second control premium from the controlling shareholder. That is hardly a cognizable threat, however, in light of the fact that control already stands with the controlling shareholder, rendering a duty to auction under Revlon clearly inapplicable. Consequently, "substantive" coercion drops out of the picture, leaving only "structural" coercion, which is termed "actionable" coercion in the Solomon progeny. Competently advised controlling shareholders will rarely make the mistake of threats that rise to the level of "structural" or "actionable" coercion because they know that courts will step in to protect minority shareholders.

CONCLUSION

The structure of corporate law, as developed by the Delaware legislature and courts, places only limited duties on the boards of subsidiaries when confronted with a tender offer from the controlling shareholder. It is sufficient for the board of the controlled company to protect the property and statutory rights of the subsidiary and provide minority shareholders with information to make an intelligent choice on whether to tender. The board has a role to play, as part of its duty of candor, to keep the minority informed, especially if a merger is to follow, so that the shareholders can evaluate their appraisal option. It is not unreasonable to ask that those directors serve as information agents for the diffuse public minority, a role that will help the shareholders make their
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ability to refuse to tender a real constraint on controlling shareholders.154

A broader role for the subsidiary board, however, is not justified under Delaware corporate law. Controlling shareholders have already paid their control premium once, either explicitly in the form of a premium by which they obtained their control bloc, or implicitly in the form of a discount in an equity carveout. Control premia are not an end in themselves; they are a price to be paid for second-guessing the business judgment of an incumbent board and nullifying the voting authority of minority shareholders. Controlling shareholders are second-guessing only themselves, and the minority shareholders have either long since lost, or never had, effective voting power.

Tender offers by controlling shareholders pose an inevitable policy tradeoff: additional protection to minority shareholders (beyond their ability to refuse to tender) against the costs imposed by more lawsuits. Courts have a role to play in policing against structurally coercive offers and retributive threats. But judicial intervention beyond that narrow scope is less clearly desirable. Whereas the Weinberger/Kahn regime strikes a balance on the side of shareholder protection, the Solomon/Glassman regime strikes a balance in favor of minimizing transaction and litigation costs. The real costs, if any, of that streamlined procedure come in the form of diminished willingness of investors to participate in partial equity carveouts, or greater concerns for target boards in responding to offers for a controlling bloc, but not all, of the company’s shares. If this happens, investment bankers can no doubt devise appropriate protections for minority shareholders against expropriation by freeze-out. The bankers can even duplicate the procedural hurdles of the entire fairness regime, if anyone wants that. The costs of the entire fairness regime, by contrast, are unavoidable, with lots of money going to lawyers and investment bankers for their services in ensuring the “fairness” of freeze-out transactions, with more money going to lawyers to prosecute and defend the inevitable class actions to challenge the “fairness” of those transactions. It would be a mistake to bring those costs back to freeze-out transactions in the name of doctrinal purity. The Delaware courts have a long history of working their way around cumbersome procedures and the Solomon/Glassman alternative squeeze-out procedure simply adds another chapter to that story.