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GOING PRIVATE: THREE DOCTRINES GONE ASTRAY

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Much attention has been devoted to the seeming inconsistency in the Delaware Supreme Court's holdings that predicate the choice of monitor governing a going-private transaction based on the form of the transaction. *Weinberger v. UOP, Inc.*[1] is the beacon of going private law, requiring controlling shareholders in a conflict-of-interest long-form merger[2] to prove the entire fairness of that transaction.[3] *Kahn v. Lynch Communication Systems, Inc.*[4] reinforced *Weinberger*'s holding by

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1. 457 A.2d 701 (Del. 1983).

2. DEL. CODE ANN. tit. 8, § 251 (2007) [hereinafter "DGCL"] (the Delaware long-form merger statute).

3. *Weinberger*, 457 A.2d at 711. As articulated in *Weinberger*, entire fairness consists of fair dealing and fair price. *Id.*

4. 638 A.2d 1110 (Del. 1994) ("Lynch I"), *aff'd*, 669 A.2d 79 (Del. 1995) ("Lynch II"). In *Lynch I*, the Delaware Supreme Court addressed an ambiguity left in the wake of *Weinberger* concerning the use of independent directors in freeze-out transactions. *Weinberger* suggested the use of a special committee of independent directors to negotiate the terms of a freeze-out transaction with the controlling shareholder, but failed to articulate whether the use of such a committee would affect the applicable monitor of the transaction. *See Weinberger*, 457 A.2d at 709 n.7. *Lynch I* affirmed that the entire fairness review is the "exclusive standard of judicial review" for interested

requiring the entire fairness monitor in long-form mergers even where the controlling shareholders have provided a method to immunize their controlling influence.[5] Against this stalwart adherence to the entire fairness monitor in conflict-of-interest long-form mergers came two unrelated decisions from the Delaware Supreme Court: *Solomon v. Pathe Communications Corp.*[6] and *Glassman v. Unocal Exploration Corp.*[7] *Solomon* held that the controlling shareholder was not required to pay a fair price in a non-coercive tender offer made with full disclosure[8] and *Glassman* held that the controlling shareholder was not

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merger transactions, irrespective of the use of an independent director committee or a majority of the minority vote requirement. 638 A.2d at 1117. *Lynch II* further clarified the scope of the entire fairness monitor, holding that entire fairness review requires "examination of all aspects of the transaction to gain a sense of whether the deal in its entirety is fair." 669 A.2d at 84. Specifically, the court considered whether a breach of one aspect of the monitor – fair dealing – necessarily rendered the entire transaction unfair. Answering in the negative, the Delaware Supreme Court affirmed the chancery court's holding that the transaction was fair as a whole, despite some evidence of unfair dealing by the controlling shareholder. *See generally* Peter V. Letsou & Steven M. Haas, *The Dilemma That Should Never Have Been: Minority Freeze Outs in Delaware*, 61 BUS. LAW. 25 (2005) (explaining the two cases in detail).

5. 638 A.2d at 1117 (keeping the monitor as entire fairness, even where the transaction has been approved by an independent committee of target directors or a vote of the majority of the minority shares, but shifting the burden to the plaintiff); *See also infra* Part III (discussing the law on controlling shareholder monitors as applied to the going-private context). *See generally* Steven M. Haas, Note, *Toward a Controlling Shareholder Safe Harbor*, 90 VA. L. REV. 2245, 2254-71 (2004) (summarizing the different standards of review in controlling shareholder transactions).

6. 672 A.2d 35 (Del. 1996).

7. 777 A.2d 242 (Del. 2001).

8. *Solomon*, 672 A.2d at 39. More precisely, *Solomon* held that a controlling shareholder owed no duty to the minority shareholders to offer a fair price in the controller's tender offer unless the offer was structurally coercive or the attendant disclosure was false or incomplete. *Id.* For a detailed examination of *Solomon*, *see* Jon. E. Abramczyk, Jason A. Cincilla, & James D. Honaker, *Going-Private "Dilemma"?—Not in Delaware: A Response*, 58 BUS. LAW. 1351, 1354-64 (2003). *See generally* Christopher A. Iacono, Comment, *Tender Offers and Short-Form Mergers by Controlling Shareholders Under Delaware Law The "800-pound Gorilla" Continues Unimpeded* – In re Pure Resources, Inc., Shareholders Litigation, 28 DEL. J. CORP. L. 645 (2003) (examining *Solomon* and the entire fairness monitors in the context of the *Pure Resources* litigation); A.C. Pritchard, *Tender Offers by Controlling Shareholders: The Specter of Coercion and Fair Price*, 1 BERKELEY BUS. L.J. 83, 89-90 (2004) (summarizing the Delaware Supreme Court's holding in *Solomon*).

required to prove entire fairness in a short-form merger.[9] It took little time to appreciate that going private through a tender offer followed by a short-form merger (hereinafter "tender offer/SFM"), rather than through a long-form merger, would allow controlling shareholders to avoid the demanding entire fairness monitor.[10] Controlling shareholders further benefit from this two-step transaction because it offers appraisal rights only to those shareholders—typically small in number—who both do not tender and who otherwise perfect their appraisal rights in the short-form merger; in contrast, a long-form merger offers the equivalent of class action appraisal rights under the auspices of the entire fairness monitor.[11]

There is little doubt that structuring a going-private transaction in two steps instead of one creates profound differences in the roles and powers of the target directors, controlling shareholders, and minority shareholders. In a one-step long-

9. *Glassman*, 777 A.2d at 248. Section 253 of the DGCL permits short-form mergers when a corporation has acquired at least ninety percent of a subsidiary's stock. DEL. CODE ANN. tit. 8, § 253 (2007). *Glassman* held that a requirement of fair dealing would be inconsistent with the legislature's purpose in enacting section 253, and a requirement of fair price is already satisfied though the section's offering of appraisal rights. 777 A.2d at 247-48. For a detailed examination of *Glassman, see* Mark I. Steinberg, *Short-Form Mergers in Delaware*, 27 DEL. J. CORP L. 489 (2002). *See generally* Abramczyk et al., *supra* note 8, at 1364-65 (detailing the facts and holding of the lower and supreme court decisions in *Glassman*); Pritchard, *supra* note 8, at 90-91 (reviewing briefly the Delaware Supreme Court's holding in *Glassman*).

10. *See* Pritchard, *supra* note 8, at 91 (declaring that "[t]ransactional planners were quick to recognize that combining the tender offer used in *Solomon* with the short-form merger used in *Glassman* could effect a squeeze-out of minority shareholders with no entire fairness review" and describing how a subsequent trio of decisions of the Delaware Chancery Court have paved the way for this two-step approach). The "trio" of cases to which *Pritchard* refers are: *In re Siliconix Inc. S'holders Litig.*, No. 18700, 2001 Del. Ch. LEXIS 83 (Del. Ch. June 19, 2001), *In re Aquila, Inc. S'holders Litig.*, 805 A.2d 184 (Del. Ch. 2002), and *In re Pure Resources Inc. S'holders Litig.*, 808 A.2d 421 (Del. Ch. 2002).

11. Given that one prong of entire fairness is fair price, courts employing the entire fairness monitor essentially offer shareholders a class-action claim for a fair price. In contrast, when shareholders have appraisal rights, that remedy is not a class-action remedy. *See* Ronald J. Gilson & Jeffrey N. Gordon, *Doctrines and Markets: Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785 (2003) (explaining that the entire fairness monitor offers the equivalent of a class action appraisal remedy for minority shareholders).

form merger, the target's board of directors must recommend the merger transaction.[12] In contrast, in the two-step going private-transaction, the subsidiary's board has no formal, statutory role as directors of either the target corporation in the tender offer or in the short-form merger.[13] While the statutory role of directors diminishes in the two-step transaction, the power of the minority shareholders increases through both voting and appraisal rights. Since a one-step transaction requires only a majority of outstanding shares to approve the transaction, controlling shareholders often own that percentage and can thus choose to effectuate the transaction even if all minority shares object. While the controlling shareholder may choose to get the approval of a majority of the minority shares in order to avoid shouldering the burden of proving entire fairness,[14] the decision to use or waive its voting advantage belongs to the controlling shareholder. In contrast, since the goal in a tender offer designed to take the target private is to secure at least ninety percent of the outstanding target shares so as to be eligible to eliminate the remaining shares through a short-form merger, controlling shareholders typically need at least some minority shareholders to elect to tender their shares. Finally, minority shareholders have a benefit in a two-step transaction because while all short-form mergers provide appraisal rights, those rights may be unavailable in some long-form mergers.[15]

12. *See* DEL. CODE ANN. tit. 8, § 251(b) (2007) ("The board of directors of each corporation which desires to merge or consolidate shall adopt a resolution approving an agreement of merger or consolidation and declaring its advisability."); *cf. id.* § 146 (2007) (permitting the board of directors to submit a matter, such as a merger agreement, to its shareholder for a vote, even if the board of directors has subsequently decided to recommend that shareholders reject or vote against the matter at hand).

13. Tender offers are not delineated in the Delaware statute; however, since a tender offer is an offer directly to the target shareholders, target directors have no formal role. Moreover, the Delaware code is clear that target directors have no role in a short-form merger. *See id.* § 253 (2007).

14. *Lynch I*, 639 A.2d at 1116 (citing Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985)) (explaining that the approval of a merger by an informed vote of the majority of the minority shareholders, "while not a legal prerequisite, shifts the burden of proving the unfairness of the merger entirely to the plaintiffs.").

15. Unless the transaction falls within an exception that restores appraisal rights, appraisal rights are unavailable in a long-form merger when the target stock is traded on a national securities exchange, or when the

These differences based on the form of the transaction have led to numerous thoughtful articles about whether there is a reasoned basis for requiring different monitors for these transactions, and if not, whether two-step going private transactions should be governed by entire fairness.[16] Focusing on these differences, the current literature has emphasized three themes. One subject of debate is whether the two unrelated decisions, *Solomon* and *Glassman*, could produce a different result when the transactions are linked.[17] For example, while *Solomon* imposes no requirement of fair price in a stand-alone, non-coercive tender offer,[18] speculation exists regarding whether the Delaware Supreme Court would adhere to this view if the tender offer was admittedly the first step in a two-

merger is exempted from shareholder vote under section 251(f) of the DGCL. *See* DEL. CODE ANN. tit. 8, § 262(b) (2007). Conversely, appraisal rights are always available in a short-form merger. *Id.* § 262(b)(3).

16. *Compare* Letsou & Haas, *supra* note 4, at 28-30 (arguing that the divergent standards resulted from an erroneous interpretation of the *Solomon* decision and advocating a return to the entire fairness standard of review of *Weinberger* for those two-step transactions where specific acts of unfair dealing are alleged), *and* Ely R. Levy, *Freeze-Out Transaction the Pure Way: Reconciling Judicial Asymmetry Between Tender Offers and Negotiated Mergers*, 106 W. VA. L. REV. 305, 309 (2004) (calling the recent Delaware law on the two-step merger transaction "misguided" and promoting exclusive application of the entire fairness monitor to interested transactions), *with* Abramczyk et al., *supra* note 8, at 1352-53 (refuting the notion that the disparate standards based on the form of the transaction creates a dilemma and maintaining that the existing safeguards in a two-step transaction are sufficient without entire fairness review), *and* Gilson & Gordon, *supra* note 11, at 786 (eschewing the entire fairness monitor and reasoning instead that the protection of the business judgment rule should apply where a going-private controlling-shareholder transaction has been approved by a "genuinely" independent special committee).

17. Gilson & Gordon, *supra* note 11, at 820-23; Letsou & Haas, *supra* note 4, at 65-71.

18. Letsou and Haas further refine this argument and contend that *Solomon* rejected a duty to offer minority shareholders a fair price in the tender offer, but did not address the issue of whether the controlling shareholder had to establish entire fairness. Letsou & Haas, *supra* note 4, at 65-69. Similarly, Gordon and Gilson contend that *Solomon* is not "doctrinally determinative" of whether freeze-out tender offers require entire fairness. Gilson & Gordon, *supra* note 11, at 826. They argue that the court's failure to require any particular price in a controlling shareholder tender offer speaks only of the controlling shareholder's fiduciary duty but does not address the obligation of target directors when confronted with such an offer. *Id.*

step going-private transaction.[19] Many articles urge the Court to adopt the entire fairness monitor regardless of the form of the going-private transaction.[20] A second theme in the literature is whether the blocking power of minority shareholders in the tender offer negates any need for a judicially-imposed entire-fairness monitor because these shareholders have the power to defeat an inadequate offer.[21] Intertwined in this debate is the issue of whether minority shareholders have the free will to reject these offers, or whether tender offers are instead inherently coercive,[22] critiquing the recent Delaware

19. *See* Gilson & Gordon, *supra* note 11, at 833-34 (advocating two approaches to harmonize the law on going-private transactions: revisiting the *Lynch I* decision or reconsideration, by the Delaware Supreme Court, of the chancery court's decisions to extend *Solomon* to freeze-outs and the two-step merger transaction); Letsou & Haas, *supra* note 4, at 59-64 (explaining that *Solomon* could be limited to its factual holding – involving only a "naked" tender offer). Thus, these authors contend that *Solomon's* holding would be inapplicable to the two-step merger, where a tender offer is only part of a larger contemplated transaction.

20. *See e.g.*, Levy, *supra* note 16, at 348-353 (arguing that the social, economic and transaction costs associated with freeze-out mergers compel exclusive application of the entire fairness monitor to such transactions); *see also* Letsou & Haas, *supra* note 4, at 28-30 (advocating the application of the entire fairness review for "traditional" freeze-out transactions to the newer two-step structure, with modification). Letsou & Haas argue that the *per se* application of entire fairness monitor mandated by the court in *Lynch I* is over-inclusive and inconsistent with prior precedent and, accordingly, advocate application of the fairness monitor to freeze-out transactions where unfair dealing beyond an assertion of inadequate price is present, "as originally devised by the Delaware Supreme Court in *Weinberger*." *Id.* at 29.

21. *See e.g.*, Abramczyk et al., *supra* note 8, at 1362-63 (stressing that the Delaware courts have repeatedly recognized that majority of the minority vote provisions "can and do" provide minority stockholders with the ability to defeat a tender offer at an inadequate price through collective action); Letsou & Haas, *supra* note 4, at 89-91 (proposing that a transaction approved by a special committee of independent directors and the minority shareholders of a corporation should not be subject to entire fairness review, and discussing the merits and criticisms of a majority of the minority shareholder vote provision). Letsou & Haas conclude that such minority voting provisions provide minority shareholders with an important veto power, particularly in light of the increasing ranks of sophisticated institutional investors. *Id.* at 91.

22. *Compare* Abramczyk et al., *supra* note 8, at 1361 (acknowledging that the tender offer structure "leaves every stockholder to make his or her own decision on whether to tender"), *with* Bradley R. Aronstam, R. Franklin Balotti & Timo Rehbock, *Delaware's Going-Private Dilemma: Fostering Protections for Minority Shareholders in the Wake of* Siliconix *and* Unocal Exploration, 58

chancery court cases that have weighed in on the side that

BUS. LAW. 519, 536-43 (2003) (defining coercion in the context of tender offers as pressure that compels shareholders to tender their shares for reasons unrelated to the merits of the offer, and asserting that "[f]ew would dispute the notion that all tender offers contain an element of coercion"), *and* Letsou & Haas, *supra* note 4, at 76-80 (comparing and contrasting the coerciveness of a tender-offer versus a negotiated merger, concluding that the tender offer is, indeed, coercive). Abramczyk et al. state that the Delaware Court of Chancery has enacted significant structural protections to reduce the coerciveness of tender offers, including a non-waivable majority of the minority vote provision, the promise to complete a second-step transaction at equivalent consideration, and a prohibition on retributive threats. Abramczyk et al., *supra* note 8, at 1361-63. Most notably, the Delaware courts have "effectively outlawed" the practice of using front-end tender offers by requiring majority shareholders to offer equivalent consideration in the back-end of the transaction. *Id.* at 1362. Therefore, "[t]he most coercive form of a tender offer, one that threatens to provide less valuable consideration in a subsequent transaction to stockholders who do not participate in the tender offer, is no longer a viable form of transaction under Delaware law." *Id. But see* Aronstam et al., *supra*, at 538 (describing how the coercive characteristics of a tender offer are not limited to front-end bids, but that all tender offers create "powerful incentives" to tender). Aronstam et al. also counter that the coerciveness of the tender offer is inextricably intertwined with the inadequacy of the appraisal remedy, such that "[m]inority shareholders receive no benefit from assurances of identical consideration at both steps of going-private transactions" if the consideration is a low-ball offer made by the majority holder who knows that the only recourse for the minority holders is appraisal, which is "replete with infirmities." *Id.* at Bradley R. Aronstam, R. Franklin Balotti, & Timo Rehbock, *Revisiting Delaware's Going-Private Dilemma Post-Pure Resources*, 59 BUS. LAW 1459, 1471 [hereinafter, "Aronstam, *Post*-Pure Resources"]; *see also infra* note 24. However, certain events outside the courts' control may contribute to the coercive nature of the tender offer and, therefore, minority shareholders remain at risk despite these procedural protections. *See* Aronstam et al., *supra*, at 540 (explaining that coercion may result when the controlling shareholder makes false, misleading or threatening disclosures, such that the minority shareholder is mis- or ill-informed). While the controlling shareholder's fiduciary duties act to police disclosure in part, the Delaware Court of Chancery has held at least on one occasion that these duties do not require the controlling shareholder to offer a recommendation to the minority shareholders on the fairness of its offer or whether tendering is in the minority's best interest. *See, e.g., In re* Siliconix Inc. S'holders Litig., No. 18700, 2001 Del. Ch. LEXIS 83, *28-*29, *37 n.45, *56-*57 (Del. Ch. July 19, 2001); Aronstam et al., *supra*, at 540 n.164 (explaining that the *Siliconix* holding seems contradictory to the holding in *Unocal* which held that the board always has an obligation to assess a takeover bid and determine whether the offer is in the best interest of the corporation and its shareholders).

such offers can be structured in a non-coercive manner.[23] Third, in evaluating whether shareholders in a two-step transaction can fend for themselves or instead need the entire fairness monitor to protect them, the literature has debated whether the appraisal remedy available in all short-form mergers realistically affords the safety net it is presumed to provide.[24]

23. *See In re Siliconix*, 2001 Del. Ch. LEXIS at *22 (holding that a controlling shareholder has no obligation to demonstrate the entire fairness of a non-coercive, voluntary tender offer that is part of a freeze-out, where no coercive tactics or misleading disclosures have been employed); *In re* Aquila, Inc. S'holders Litig., 805 A.2d 184, 190 (Del. Ch. 2002) (holding that "Delaware law does not impose a duty of entire fairness on controlling stockholders making a non-coercive tender or exchange offer to acquire shares directly from the minority holders"); *In re* Pure Resources Inc. S'holders Litig., 808 A.2d 421 (Del. Ch. 2002) (recognizing that tender offers are inherently coercive, but delineating four conditions which, if fulfilled by the controlling shareholder, may render the tender offer non-coercive); *see also infra* note 39 and accompanying text (listing the four conditions). These courts have defined voluntary tender offers to mean that minority shareholders have neither been forced to accept the offer nor misled. *E.g., In re Siliconix*, 2001 Del. Ch. LEXIS at *22 ("The issue of voluntariness of the tender depends on the absence of improper coercion and the absence of disclosure violations."); *see also Solomon*, 672 A.2d at 39 (citing Eisenberg v. Chicago Milwaukee Corp., 537 A.2d 1051, 1056 (Del. Ch. 1987)) ("[T]he determinative factor as to voluntariness is whether coercion is present, or whether there is materially false or misleading disclosures made to shareholders in connection with the offer.") (internal quotations omitted).

24. *Compare* Abramczyk et al., *supra* note 8, at 1366-70 (discussing the adequacy of the appraisal remedy and concluding that these inadequacies further contribute to the coerciveness), *with* Aronstam et al., *supra* note 22, at 543-48 (detailing those aspects of appraisal which make it an inadequate remedy for minority shareholders in going-private transactions, and concluding that this inadequacy further contributes to the coerciveness of tender offers), *and* Richard T. Hossfeld, Note, *Short-Form Mergers After* Glassman v. Unocal Exploration Corp.*: Time to Reform Appraisal*, 53 DUKE L.J. 1337, 1357 (2004) (noting that the appraisal remedy in short-form mergers "facilitates the market for corporate control, but it neither provides minority shareholders adequate liquidity nor checks majority shareholder opportunism"), *and* Steinberg, *supra* note 9, at 498 (concluding that the appraisal remedy is adequate only to protect minority shareholders in a short-form merger if there is sufficient disclosure of material facts, without which minority shareholders "may be lulled into inaction, bypassing their appraisal rights"). Among the reasons commonly cited as support for the inadequacy of the appraisal remedy are that shareholders must "opt-in" by serving written demand on the parent corporation and follow other procedures under DGCL § 262(d)(2), shareholders must petition to the Delaware Chancery

My intent is not to rehash these arguments, for the literature has already amply explored both sides of these debates. Instead, this Article will address the missing broader perspective on these transactions, for the concerns raised in these cases run much deeper than the commentary to date acknowledges. The issue is not simply one's opinion of the efficacy of appraisal rights, or of whether controlling-shareholder tender offers are inherently coercive, or of whether entire fairness should monitor all going-private transactions. Instead, the broader issue is how established doctrinal law would answer this going-private dilemma. Specifically, the fact pattern of these going-private cases presents the collision of three strands of well-developed doctrinal law: the *Schnell* doctrine,[25] the doctrine of "independent legal significance" (hereinafter "ILS"),[26] and the law governing controlling-shareholder fiduciary duties.[27] Each doctrine alone, as well as the intersection of the three, has, to date, received surprisingly scant attention when each should have provided an important guidepost towards resolving the going-private dilemma. The courts' application of these doctrines in the going-private context also impacts on the viability of these doctrines in other areas of the law.

Court for an appraisal proceeding at which a complicated valuation of the corporation's shares, requiring expensive expert witnesses, takes place, and the delay of time between demand for appraisal and resolution, during which the minority shareholders must forgo consideration and expend considerable costs in litigation. *See generally* Aronstam et al., *supra* note 22, at 543-58 (advocating for a re-examination of *Glassman's* holding, limiting shareholders in a short-form merger solely to the appraisal remedy, or, alternatively, a revision of the appraisal statute).

25. *See infra* Part I (discussing the scope of the *Schnell* doctrine, its proper place, as a per se rule, in a court of equity, and the arguably questionable application of the doctrine in the case of *In re Pure Resources*, to the actions of a controlling shareholder).

26. *See infra* Part II (reviewing the contours of the doctrine of independent legal significance, its relationship to the *Schnell* doctrine and the monitor of entire fairness, and the *In re Pure Resources* court's cursory treatment of the doctrine as a defense to the controlling shareholder transaction at issue).

27. *See infra* Part III (describing the tension between controlling shareholders' right to act in their own self interest and their fiduciary duties and advocating a reconsideration of the Delaware Supreme Court's reasoning in *Lynch I* and *Weinberger*, which together required a fairness monitor for all controlling shareholder transactions in contrast to its prior holding in the case of *Sinclair Oil Corp. v. Levien*, which required entire fairness only if the controlling shareholder is first found to be self-dealing).

The *Schnell* doctrine is an equitable doctrine named for the case in which the doctrine was first enunciated, *Schnell v. Chris-Craft Industries*.[28] That doctrine states that technical compliance with the corporate statute will not, by itself, validate a transaction if the corporate action is inequitable.[29] In contrast to this equitable doctrine, the doctrine of ILS is a rule of statutory construction that allows directors the freedom to choose between statutory transactions without regard to the effect that choice may have on shareholders, such as denying them rights that the other avenue would have provided.[30] For example, in *Hariton v. Arco Electronics, Inc.*,[31] the Delaware Supreme Court upheld the right of corporate directors to structure a transaction as a two-step sale of assets followed by a liquidation, rather than as a merger, even though the latter would give the shareholders appraisal rights while the former two-step transaction would not. The Court reasoned that since the legislature had created two independent paths by which the corporation could accomplish its goal, it was not up to the judiciary to require the corporation to choose a particular path. Instead, the court held that the statutory provisions were of independent and equal legal significance.[32] The *Schnell* and ILS doctrines, however, are inherently contradictory: if directors choose a path under ILS that does not grant shareholders certain rights, can the directors' choice of form that is less favorable to their shareholders be deemed inequitable under *Schnell*? Current going-private transactions pose that explicit question because when a fiduciary takes a corporation private through a tender offer/SFM—as ILS allows—that choice triggers the

28. 285 A.2d 437 (Del. 1971).

29. *Id.* at 439; *see also infra* notes 44-45 and accompanying text (explaining the Delaware Supreme Court's holding in *Schnell*).

30. Orzeck v. Englehart, 195 A.2d 375, 377 (Del. 1963) ("[A]ction taken in accordance with different sections of that law are acts of independent legal significance even though the end result may be the same under different sections."); *see, e.g.*, Rothschild Int'l Corp. v. Liggett Group, Inc. 474 A.2d 133, 136 (Del. 1984) (finding the merger and liquidation paths to be of independent legal significance, even though rights for preferred shares' preference varies between the two); Hariton v. Arco Elecs., Inc, 188 A.2d 123, 125 (Del. 1963) (holding the sale-of-assets statute and merger statute to be independent of each other and of "equal dignity"); *see also infra* notes 138-144 and accompanying text (explaining the doctrine).

31. 188 A.2d 123 (Del. 1963).

32. *Id.* at 125.

question of whether the court can deem that election inequitable under *Schnell* because the chosen route does not offer shareholders the benefits of the entire fairness monitor that long-form mergers provide.

The third doctrine in play in going-private transactions is fiduciary law. While it is indisputable that controlling shareholders owe fiduciary duties to minority shareholders,[33] such platitudes only beg the question. The duties of controlling shareholders are more contextual. Thus, the pivotal question is what those duties require of controlling shareholders in the context of a two-step going-private transaction.

Parts I, II, and III of this Article address the *Schnell,* ILS and controlling-shareholder doctrines, respectively. In each section, the Article uses a leading tender offer/SFM case, *In re Pure Resources, Inc. Shareholders Litigation*[34], to explicate the issues in each doctrine. In *Pure Resources,* Unocal, the owner of sixty-five percent of the shares of Pure, made a tender offer for the remaining thirty-five percent. Unocal conditioned its offer on receiving a majority of the minority shares, and further declared that if it received sufficient tenders so that it owned ninety percent of Pure, it would effectuate a short-form merger.[35] Pure shareholders sought to enjoin the tender offer, arguing that *Kahn*'s entire fairness test should apply to this inherently coercive tender offer.[36] In response, Unocal contended that *Solomon,* not *Kahn,* governed tender offers, and *Solomon* required only that the offeror not "structurally coerce" the minority shareholders or mislead them with defective disclosure.[37] Although uneasy about the inconsistent standards between *Kahn* and *Solomon,* Vice Chancellor Strine held in *Pure Resources* that *Solomon* governs a controlling-shareholder

33. *See* Singer v. Magnavox, 380 A.2d 969, 976-77 (Del. 1977) ("It is settled Delaware law . . . [that] controlling shareholders owe their corporation and its minority shareholders a fiduciary obligation of honesty, loyalty, good faith and fairness.") (internal citations omitted).; Mary Siegel, *The Erosion of the Law of Controlling Shareholders*, 24 DEL. J. CORP. L. 27, 47-70 (1999) (tracing the law and fiduciary duties governing controlling shareholders); *see also infra* note 184 (providing parallel sources for the notion that controlling shareholders have fiduciary duties).

34. 808 A.2d 421 (Del. Ch. 2002).

35. *Id.* at 430 (listing the key features of the Unocal offer).

36. *Id.* at 432-33 (describing the Pure Resources' shareholders' case for a preliminary injunction against the tender offer).

37. *Id.* at 433.

tender offer which seeks to acquire all of the remaining shares either from the offer or in conjunction with a short-form merger.[38] The court delineated four criteria for such a tender offer to qualify as not coercive: it must be conditioned on a majority of the minority shares accepting the offer; it must promise to consummate a prompt short-form merger at the tender offer price if the offeror becomes the owner of ninety percent or more of the target's shares; it must be free of threats from the controlling shareholder regarding the implications of a failed offer; and it must be accompanied by a full and fair disclosure of all material facts.[39] The court found that Unocal's offer was coercive because it improperly classified some interested shares as part of the minority group,[40] but gave Unocal leave to amend the offer to identify properly Pure's unaffiliated shares.[41]

This Article contends that the holding in *Pure Resources* is correct but takes issue with the court's analysis and application of the three pivotal doctrines. *Pure Resources'* capacious view of the *Schnell* doctrine and its dismissive view of the doctrine of ILS are inconsistent with the case law. The greater concern,

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38. *Id.* at 424 ("In this opinion, I conclude that the Offer is subject, as a general matter, to the *Solomon* standards, rather than the *Lynch* entire fairness standard.").

39. *Id.* at 445.

> [O]ur law should consider an acquisition tender offer by a controlling stockholder non-coercive only when: 1) it is subject to 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% of the shares; and 3) the controlling stockholder has made no retributive threats.

Vice Chancellor Strine also imposed a fourth condition: "the independent directors on the target board both free rein and adequate time to react to the tender offer, by (at the very least) hiring their own advisors, providing the minority with a recommendation as to the advisability of the offer, and disclosing adequate information for the minority to make an informed judgment." *Id.*

40. *Id.* at 446 (describing how Unocal impermissibly included directors and officers of Unocal as part of the "minority" in calculating its majority of the minority requirement).

41. *Id.* at 446-47 (concluding that this miscalculation could easily be "cured" by excluding interested shareholders from the minority class and that the Unocal offer was otherwise "non-coercive" because Unocal had not made any retributive threats and intended to promptly consummate the second-step merger).

however, is that the court's use of the *Schnell* doctrine would allow it to nullify virtually any conduct or any aspect of any transaction. Finally, the court in *Pure Resources* failed to tailor its analysis specifically to the fiduciary duties of controlling shareholders, rather than fiduciary duties in general. The primary source of this analytic problem is the Delaware court's failure to follow prior case law that identifies when a controlling shareholder must prove entire fairness. As a result, the court's analysis dangerously broadens the duties of controlling shareholders. In explaining the debatable analysis of these doctrines in *Pure Resources*, this Article highlights the significant implications resulting from the distortion of these doctrines.

I.
THE *SCHNELL* DOCTRINE

The *Schnell* doctrine is doctrine justifying a court's use of its equitable powers to invalidate conduct by fiduciaries that satisfies every legal requirement but which the court nevertheless finds is inequitable. In *Schnell,* insurgent shareholders of Chris-Craft Industries waged a proxy fight. To thwart insurgents' efforts, the directors moved both the date and location of the corporation's annual meeting.[42] Since the corporate statute and the corporation's charter permitted the directors to take the actions they chose, the chancery court upheld the board's response.[43] On appeal, however, the Delaware Supreme Court reversed. In the articulation of what thereafter became known as the "*Schnell* doctrine," the Court stated that "inequitable action does not become permissible simply because it is legally possible."[44] The Supreme Court reasoned

42. Chris-Craft's directors moved up the date of the meeting from January 11, 1972, to December 8, 1971, in order to give the insurgents less time to prepare and solicit proxies. The directors moved the location of the meeting to Cortland, New York, where the company had a plant, with the hope that the cold, snowy weather of upstate New York in December would deter shareholders from attending the meeting. Schnell v. Chris-Craft Indus., Inc., 285 A.2d 430, 432-34 (Del. Ch. 1971) [hereinafter "*Schnell Chancery Court Opinion*"], *rev'd,* Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971) [hereinafter "*Schnell*"].

43. *Schnell Chancery Court Opinion,* 285 A.2d at 437.

44. *Schnell,* 285 A.2d. at 439. The concept that legally prescribed conduct can nonetheless be found inequitable by a reviewing court is firmly rooted in

that because the directors purposefully manipulated the electoral machinery in order to entrench themselves in power, their actions were inequitable even though they fully complied with corporate law. Thus, satisfying the explicit terms of the corporate statute and relevant documents would not provide a safe harbor; the court reserved the power to intervene if the fiduciary's conduct was unfair despite its legality.[45] If fiduciaries played a game of "gotcha," the courts would play their trump card.

While the *Schnell* doctrine on its face has no topical boundaries, the classic *Schnell* cases involve "situations where boards deliberately employed various legal strategies either to frustrate or completely disenfranchise a shareholder vote."[46] Within the broad array of fact-patterns that can negatively impact on the shareholder vote are two topics that surface as clearly within *Schnell*'s ambit. One line of cases, exemplified by *Schnell* itself, relates to the directors moving the date of the annual meeting so as to thwart an anticipated or ongoing proxy fight.[47] For example, in *Aprahamian v. HBO & Co.*,[48] the

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corporate law, and can be traced to the seminal article by Adolphe A. Berle, *Corporate Powers As Powers In Trust*, 44 HARV. L. REV. 1, 1049 (1931), where he proclaimed: "[I]n every case, corporate action must be twice tested: first, by the technical rules having to do with the existence and proper exercise of the power; second, by equitable rules somewhat analogous to those which apply in favor of a cestui que truest to the trustee's exercise of wide powers granted to him in the instrument making him a fiduciary."

45. *See, e.g.*, Aprahamian v. HBO & Co., 531 A.2d 1204, 1208-09 (Del. Ch. 1987) (finding a *Schnell* violation and enjoining directors' change of date of the shareholder meeting after directors learned that dissident shareholders might have sufficient votes to oust directors); Lerman v. Diagnostic Data, Inc., 421 A.2d 906, 914 (Del. Ch. 1980) (finding a *Schnell* violation and invalidating director-enacted inequitable bylaws). Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401, 408-09 (Del. 1985) (considering *Schnell* but allowing majority shareholder's enactment of restrictive bylaws); Huffington v. Enstar Corp., No. 7543-NC, 1984 Del. Ch. LEXIS 492 (Del. Ch. Apr. 25, 1984) (finding no *Schnell* violation and permitting directors to change the date of the shareholder meeting).

46. Stroud v. Grace, 606 A.2d 75, 91 (Del. 1992) (discussing that there can be no question that board action "intended to thwart free exercise of the [shareholder] franchise" violates Delaware law under the *Schnell* doctrine).

47. *See, e.g.*, *Lerman*, 421 A.2d at 911-14 (citing *Schnell* to invalidate director-enacted bylaws that made it impossible for insurgents to qualify for the elections); *Aprahamian*, 531 A.2d at 1208-09 (citing *Schnell* to enjoin directors from changing the date of shareholder meeting). *Cf.* Perlegos v. Atmel Corp., Nos. 2320-N, 2321-N, 2007 Del. Ch. LEXIS 25 (Del. Ch. Feb. 8, 2007)

court enjoined the directors' attempt, on the eve of the annual meeting, to postpone that meeting once the directors realized they were likely not to be re-elected.[49] Similarly, in *Lerman v. Diagnostic Data, Inc.*,[50] the court enjoined directors' actions that consisted of indefinitely extending the meeting date and subsequently enacting bylaws which made it impossible for insurgents to qualify for those elections.[51] In contrast, however, there are a handful of cases involving switching the date of the annual meeting in which the court did not find *Schnell* violations. In *Stahl v. Apple Bancorp, Inc.*,[52] for example, the court held that the directors' deferring the meeting date in the face of a likely loss in an impending proxy contest was not inequitable because the meeting would definitely occur on the new meeting date, necessarily allowing the election process to proceed at a date certain.[53] Similarly, in *Dolgoff v. Projectavision, Inc.*,[54] the directors' electing the first possible meeting date to formally sever their ties with a now-fired director was not inequitable because their action did not disenfranchise any share-

(citing Blasius Indus. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1988), as opposed to *Schnell*, to enjoin the cancellation of the special shareholder meeting which had the effect of precluding shareholders from voting on the removal of the directors until the next regularly-scheduled meeting). The applicability of the *Schnell* doctrine outside Delaware is also well established. *See, e.g.*, Shoen v. Amerco, 885 F. Supp. 1332, 1340, 1352 (D. Nev. 1994) (finding that the *Schnell* doctrine and not the business judgment rule applies when directors manipulate the timing of a shareholder meeting and that "the denial or frustration of the right of shareholders to vote their shares or obtain representation on the board of directors amounts to an irreparable injury").

48. 531 A.2d at 1204.

49. *Id.* at 1208 (discussing that the incumbent directors had already designated the date for the annual meeting and solicited proxies on their behalf).

50. *Lerman*, 421 A.2d at 906.

51. *Id.* at 913-14 (noting that of great significance in invalidating directors' actions to extend the meeting date and enact restrictive bylaws under *Schnell* was defendants' knowledge that plaintiff intended to wage a proxy fight).

52. 579 A.2d 115 (Del. Ch. 1990).

53. *Id.* at 1123, 1125 (reasoning that "While the refusal to call a shareholder meeting when the board is not obligated to do so might under some imaginable circumstance breach a fiduciary duty, such a decision does not itself constitute an impairment of the exercise of the franchise that sparked the close judicial scrutiny of *Schnell*. . .").

54. No. 14805, 1996 Del. Ch. LEXIS 24 (Del. Ch. Feb. 29, 1996).

holders.[55] In both *Stahl* and *Dolgoff*, the election process ultimately proceeded consistently with company bylaws and did not preclude any shareholders from effectively exercising their votes.[56]

The second clear *Schnell* topic involves directors passing advance notice provisions for the nomination of directors in such a way as to make a proxy fight impossible, or nearly so. In *Linton v. Everett*,[57] for example, shareholders had only three days to propose a competing slate of directors.[58] The court invoked the *Schnell* doctrine to invalidate these bylaws because the directors' actions required the shareholders to be in a state of "shelf-readiness" if they wanted to propose alternative candidates.[59] Similarly, in *Lerman v. Diagnostic Data, Inc.*,[60] the advance notice provision of seventy days was held invalid where the meeting date was set sixty-three days away, thereby having a "terminal effect" on the dissidents' chance of succeeding in a proxy fight.[61] In contrast, in *Accipiter Life Scis. Fund, L.P. v.*

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55. *Id.* at *25-26 (holding that "the Board did not seek to thwart the exercise of the shareholder franchise but sought, in a context where there was no reason to believe a proxy contest was at hand, to conclude [the ousted director's] service on the board"). The court also stated that "the fact that the scheduling of the meeting may have caught [him] by surprise . . . is simply not grounds for enjoining an otherwise properly and legally noticed shareholders' meeting." *Id.* at *25.

56. *Stahl*, 579 A.2d at 1123 ("Defendant's decision does not preclude plaintiff or any other Bancorp shareholder from effectively exercising his vote, nor have proxies been collected that only await imminent counting"); *Dolgoff*, 1996 Del. Ch. LEXIS 24, at *25-26 ("[W]hile the board had strategic aims in calling a meeting for February, those were not inappropriate or inequitable").

57. No. 15219, 1997 Del. Ch. LEXIS 117, at *26-28 (Del. Ch. July 31, 1997).

58. In *Linton*, the existing directors had authorized an issuance to themselves of common stock approximately equal to 5.4% of outstanding shares. *Id.* at *26-28. With the meeting to reelect them being called on three days notice, the Court agreed with the plaintiffs that there were "highly unusual circumstances . . . especially the fact that the corporation had had no shareholders meetings for three years [and that] basic fairness required more than the minimal notice given." *Id.* at *28.

59. *Id.* at *35.

60. 421 A.2d 906, 911-14 (Del. Ch. 1980).

61. *Id.* at 912; *see also* Hubbard v. Hollywood Park Realty Enters., Inc., No. 11779, 1991 WL 3151, at *11 (Del. Ch. Jan. 14, 1991) ("That [voting rights] are fundamental does not mean that their exercise cannot be restricted for valid corporate purposes by board-created procedural rules. However, those

Helfer,[62] the court decided that the advance notice requirement was not inequitable both because the corporation had no knowledge that plaintiff contemplated a proxy fight and because plaintiff conceded that he had not read the shareholder-meeting announcement that contained information on the advance notice requirements.[63] In denying plaintiff relief, the court reasoned that it would use its *Schnell* powers only "where compelling circumstances suggest that the company unfairly manipulated the voting process in such a serious way as to constitute an evident or grave incursion into the fabric of the corporate law."[64]

Since cases raising voting issues cover a wide spectrum of fact patterns, it is sometimes unclear whether the chancery court will apply *Schnell's per se* rule, or whether it will instead invoke a related doctrine created in *Blasius Indus. Inc.v. Atlas Corp.*[65] In *Blasius*, the Delaware chancery court articulated two reasons that require courts to scrutinize carefully any efforts to interfere with the shareholders' right to vote. First, the court reasoned that the integrity of the shareholder vote legitimizes directors' exercise of power over the corporate property.[66] Second, in identifying the respective powers of the directors and the shareholders, the court reasoned that the business

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restrictions must not infringe upon the exercise of those rights in an unreasonable way."); *Cf.* Int'l Banknote Co. v. Muller, 713 F. Supp. 612, 623 (S.D.N.Y. 1989) ("Courts have consistently found that corporate management subjects shareholders to irreparable harm by denying them the right to vote their shares or unnecessarily frustrating them in their attempt to obtain representation on the board of directors").

62. 905 A.2d 115 (Del. Ch. 2006).

63. *Id.* at 127 (discussing that the act of burying notice in a press release, though duplicitous, did not deprive shareholders of their right to make a proposal).

64. *Id.*

65. 564 A.2d 651 (Del. Ch. 1988). *See e.g.*, Mentor Graphics Corp. v. Quickturn Design Sys., Inc., 728 A.2d 25, 37 (Del. Ch. 1998), *aff'd sub nom*, Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1287-88 (Del. 1998) (discussing plaintiff's argument that, under *Blasius*, a By-Law Amendment impermissibly impedes the stockholder franchise by imposing a 90-100 day delay between the date of a call for a special stockholders meeting and the date of that meeting, and a 71 day delay between the meeting date noticed by plaintiff and the meeting date noticed by defendant); *MM Cos.*, 813 A.2d at 1132 (applying the *Blasius* compelling justification standard to invalidate board expansion designed to thwart shareholder vote).

66. *Blasius*, 564 A.2d at 659.

judgment rule is inapplicable to the question of whom the shareholders should elect to the board of directors.[67] As a result, the court created a two-prong test: if the plaintiff first establishes that the board acted for the primary purpose of thwarting the exercise of a shareholder vote, then the board must demonstrate a compelling justification for its actions.[68] Therefore, if directors demonstrate that their primary purpose was not to obstruct shareholder voting, the court will apply the business judgment rule, rather than the compelling justification test,[69] even though the directors' conduct interfered with the vote.[70]

In *Blasius*, the chancery court held that the directors' actions were designed primarily to prevent a dissident shareholder from enlarging the board so as to stack it with his nominees. As such, the directors, although acting in good faith, were required to pass the compelling justification test, a test

67. *Id.* (discussing that "matters involving the integrity of the shareholder voting process involve consideration not present in any other context in which directors exercise delegated power," such that "the ordinary considerations to which the business judgment rule originally responded are simply not present in the shareholder voting context").

68. *Id.* at 662; *see also* Williams v. Geier, 671 A.2d 1368, 1376 (Del. 1996) (reasoning "the application of the 'compelling justification' standard set forth in *Blasius* is appropriate only where the 'primary purpose of the board's action (is) to interfere with or impede exercise of the shareholder franchise' and the stockholders are not given a 'full and fair opportunity to vote'." (quoting Stroud v. Grace, 606 A.2d 75, 92 (Del. 1992)).

69. *Williams*, 671 A.2d at 1376 (citing Stroud v. Grace, 606 A.2d 75, 92 (Del. 1992) (discussing that the business judgment rule applies where disenfranchisement is not the 'primary purpose' of the relevant board action); *see also* Wisconsin v. Peerless Sys. Corp., No. 17637, 2000 WL 1805376, at *9-10 (Del. Ch. Dec. 4, 2000) (citing Apple Computer, Inc. v. Exponential Tech., Inc., No. 16315, 1999 WL 39547, at *5 n.20 (Del. Ch. Jan. 21, 1999) (discussing that "a board's unintentional failure to fulfill its statutory obligations, while perhaps constituting a breach of the fiduciary, duty of care, does not ordinarily trigger *Blasius* review as long as the 'primary purpose' of the board's action was not to interfere with or impede exercise of the shareholder franchise." (quoting Williams, 671 A.2d at 1276))); *In re* The MONY Group Inc. S'holder Litig., 853 A.2d 661, 674-78 (Del. Ch. 2004).

70. *See, e.g.*, *Williams*, 671 A.2d at 1385 (concluding that the board had several legitimate reasons for its recapitalization plan that demonstrated that the board was not acting primarily to disenfranchise its shareholders, thus *Blasius* did not apply); Stroud v. Grace, 606 A.2d 75, 91 (Del. 1992) (holding that the board was not acting to disenfranchise shareholders and that *Blasius* did not apply).

they ultimately failed to satisfy.[71] Similarly, in *Chesapeake Corp. v. Shore*,[72] the chancery court held that the board's adoption of a supermajority voting provision was primarily for the purpose of thwarting a takeover by a controlling shareholder, and found that this purpose failed the compelling justification test.[73] The Delaware Supreme Court also applied the *Blasius* doctrine both where the board enacted bylaws establishing procedures for nominating candidates to the board of directors[74] and where the board took defensive measures that changed the size and composition of the board;[75] in both scenarios, once the Court determined that the board's action was taken for the primary purpose of disenfranchising shareholders, that conduct likely fails the compelling justification test. In fact, given the demanding nature of the compelling justification test, only one case—a very recent one at that—has ever

71. *See Blasius*, 564 A.2d at 659.

72. 771 A.2d 293 (Del. Ch. 2000).

73. *Id.* at 345 (holding that the 'compelling justification' standard applies and the defendant's argument that "superior access to company information—they 'know[ ] better than . . . the stockholders' about 'who should comprise the board of directors'" provides "no legitimate justification at all." (quoting *Blasius*, 562 A.2d at 662-63)); *see also Peerless*, 2000 WL 1805376, at *11-12 (finding that the primary purpose of an adjournment of a special meeting of the stockholders was to interfere with the shareholder vote, and also discussing the Court's assumption that the board was acting in good faith and the fact that good faith action can still lead to unintended violations of the duty of loyalty). *Cf.* IBS Fin. Corp., v. Seidman & Assoc., L.L.C., 954 F. Supp. 980, 994 (D.N.J. 1997) (applying *Blasius*, discussing that election of directors must be effectuated by shareholders and cannot be "usurped by a board of directors, however good-intentioned.").

74. *Stroud*, 606 A.2d at 95-96 (applying *Blasius* because the court found that the by-law's primary purpose was to disenfranchise shareholders, but ultimate determination of whether defendants satisfied compelling justification test of inequity had to await the by-law's "actual use"); *see also* Jack B. Jacobs, *The Uneasy Truce Between Law and Equity in Modern Business Enterprise Jurisprudence*, 8 DEL. L. REV. 1, 11-13 (2005) (reading the Delaware Supreme Court's reversal of the Chancery Court's opinion in *Stroud* as illuminating the "latter-day renewal" of tension present between law and equity by holding that the chancery court had "no power to expand . . . statutory requirements through the application of common law equitable principles").

75. *MM Cos.*, 813 A.2d at 1132 (Del. 2003) (finding board expansion was invalid under *Blasius* because the defendant failed to establish a compelling justification for its defensive action).

satisfied it.[76] Phrased differently, defendants do not prevail when a court finds the *Blasius* test applicable.

If there is teleology to those voting cases to be decided under *Schnell* as opposed to those to be decided under *Blasius*, the Delaware courts have been atypically vague in identifying that line of demarcation. While the Delaware courts are both protective of the shareholders' right to vote and instinctively able to respond well to fact patterns that threaten that right, they have failed to articulate a clear theory regarding which voting cases belong under *Schnell*, *Blasius*, or some other doctrine. Consider the Delaware courts' statements about *Schnell*. In *Stroud*, the Delaware Supreme Court described the *Schnell* doctrine as primarily limited to those situations where "boards of directors deliberately employed various legal strategies either to frustrate or completely disenfranchise a shareholder vote."[77] How is that test qualitatively different from the chancery court's description in *Blasius* that the compelling justification test applies when the board acts "for the primary purpose of interfering with the effectiveness of a stockholder vote"?[78] Reinforcing this overlap between the two cases are those vot-

76. Mercier v. Inter-Tel, Inc., 929 A. 2d 786, 819 (Del. Ch. 2007). *See also* discussion *infra* notes 90-101 and accompanying text.

77. 606 A.2d at 91; *see also In re* The MONY Group Inc. S'holder Litig., 853 A.2d 661, 676 (Del. Ch. 2004) (reasoning that *Schnell* precludes a board from coercing the shareholder vote by agreeing to high termination fees) (citations omitted).

78. *Blasius*, 564 A.2d at 659; *see also MM Cos.*, 813 A.2d at 1128 (invalidating, under *Blasius*, board expansion designed to thwart shareholder vote). Another example of the overlap between the two doctrines occurs when a board votes to issue more stock, diluting existing shareholders. Is that dilutive issuance a voting mechanic to be judged under *Schnell* or a transaction whose primary purpose is to interfere with the shareholder franchise under *Blasius*? For example, in *Packer v. Yampol*, the Chancery Court reasoned, under *Schnell*, that "a board of directors may not use the corporate machinery for the purpose of obstructing the legitimate efforts of dissident stockholders to undertake a proxy contest against management." 1986 Del. Ch. LEXIS 413, at *38 (Del. Ch. Apr. 18, 1986) (citation omitted); *see also* Frantz Mfg. Co., 501 A.2d at 408-09 (finding under *Schnell* that board's funding of an ESOP was inequitable as the dilutive issuance had the "primary purpose of perpetuating . . . control" and disenfranchising shareholders). *Packer*, however, was decided before *Blasius*. Presaging *Blasius*, the court stated: "While raising capital may have been a purpose for the directors' conduct, *their primary purpose was to obstruct plaintiffs' ability to wage a meaningful proxy contest* in order to maintain themselves in control." *Packer*, 1986 Del. Ch. LEXIS, at *15. (emphasis added). Hence, a dilutive issuance such as the one

ing cases that cite both doctrines.[79] Furthermore, little light is shed on these voting cases by *Alabama By-Products Corp. v. Neal*,[80] which admonished courts to limit the *Schnell* doctrine to cases that "threaten the fabric of law" or would "deprive a person of a clear right."[81] As Justice Jacobs aptly noted, *Alabama's* admonition is difficult to apply: what criteria should a court use to determine what will "threaten the fabric of law"? Similarly, equitable relief should not be needed to prevent the loss of a clear right, as the clarity of the right should itself provide the basis for relief.[82]

While the standards that *Alabama By-Products* articulates for the applicability of *Schnell* are questionable, its underlying

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in *Packer*, though *Packer* was decided under *Schnell*, could have been properly decided under *Blasius* had that doctrine been in existence.

79. *See* Aprahamian, 531 A.2d at1207-08; Phillips v. Insituform of N. Am., Inc., 1987 Del. Ch. LEXIS 474, at *25-27 (Del. Ch. Aug. 27, 1987); *MM Cos.*, 813 A.2d at 1128. Interpreting *Blasius*, the Court in *MM Cos.* stated that:

> [T]he ordinary considerations to which the business judgment rule originally responded are simply not present in the shareholder voting context. . . . That, of course, is true in a very specific way in [a] case which deals with the question who should constitute the board of directors of the corporation . . . Action designed principally to interfere with the effectiveness of a vote inevitably involves a conflict between the board and shareholder majority. Judicial review of such action involves a determination of the legal and equitable obligations of an agent towards his principal. . . . This is not, in my opinion, a question that a court may leave to the agent finally to decide so long as he does so honestly and competently.

Id. at 1128. Yet, in holding the board's action invalid, the Court rested on *Schnell's* often stated "venerable principle" that "inequitable action does not become permissible simply because it is legally possible." *Id.* at 1132 (citing *Schnell*, 285 A.2d at 439).

80. 588 A.2d 255 (Del. 1991).

81. *Id.* at 258 n.1 (stating that "overrid[ing] established precepts of Delaware corporate law must be [done] with caution and restraint").

82. Jacobs, *supra* note 74, at 11. Specifically, Justice Jacobs asked:

> How does one decide whether fiduciary conduct "threatens the fabric of the law?" And if equity can be used to override the law only where an "improper manipulation of the law would deprive a person of a clear right," why is equity needed at all, since if the right being violated is clear, that alone would afford a basis for relief. Finally, that formulation seemed inconsistent with the equitable doctrine that animates cases such as [*Schnell*], which is that equitable principles can be used to restrain fiduciary conduct that the fiduciary otherwise has a "clear right" to engage in.

Id.

concern that *Schnell* should be cabined is well founded. On its face, *Schnell* has no topical boundaries and no standards for the court to judge whether the legal action is nevertheless inequitable. Therefore, it is not surprising that the case law is replete with examples of the Delaware courts citing *Schnell* in a variety of unrelated contexts.[83] Such a random and indiscriminate use of the *Schnell* doctrine, however, is problematic.[84] By allowing courts to superimpose their views of fairness through these equitable powers, application of the *Schnell* doctrine creates uncertainty for fiduciaries who are unsure when their compliance with the statute will be deemed, *ex post*, insufficient.[85] Moreover, given the indeterminacy of the doctrine, transaction planners cannot provide the missing comfort level to their clients. Furthermore, knowing that courts will examine the equities of a transaction which otherwise fully complies with the corporate statute emboldens shareholders to sue

83. *See, e.g.*, Del. Ins. Guar. Ass'n v. Christiana Care Health Servs., 892 A.2d 1073, 1078 n.20 (Del. 2006) (*Schnell* cited for its general rule by successor to insurance claim); *In re* Holly Farms Corp. S'holders Litig., 1989 Del. Ch. LEXIS 28, at *28 (Del. Ch. Mar. 22, 1989) (citing *Schnell* where stockholders wished to enjoin vote on a merger where their challenges had not yet been resolved); Seagraves v. Urstadt Property Co., 1989 Del. Ch. LEXIS 155, at *12 (Del. Ch. Nov. 13, 1989) (articulating claims by minority shareholder in a cash-out merger that acts of delisting of shares and the nonpayment of dividends were committed for an inequitable purpose and were therefore invalid under *Schnell*); Smith v. SPNV Holdings, Inc., 1987 Del. Ch. LEXIS 505, at *8 (Del. Ch. Oct. 28, 2007) (citing *Schnell* to support that "[u]nfair dealing by a controlling shareholder is not permitted regardless of the action's legality").

84. Professor Branson argues this practice has obscured the meaning and importance of the *Schnell* doctrine, allowing it to become nothing more than "a kind of universal solvent for courts and plaintiffs." Douglas M. Branson, *Indeterminacy: The Final Ingredient in an Interest Group Analysis of Corporate Law*, 43 VAND. L. REV. 85, 100 (1990) (discussing *Schnell*'s expansion beyond its traditional bounds under Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099 (Del. 1985), where the doctrine was applied to defendant's claim that it was under no obligation to cash out remaining shareholders for a specified price within one year of the acquisition).

85. Leo E. Strine, Jr., *If Corporate Action Is Lawful, Presumably There Are Circumstances In Which It Is Equitable To Take That Action: The Implicit Corollary To The Rule of* Schnell v. Chris-Craft, 60 BUS. LAW. 877 (2005) (discussing, among other issues, the tendency of law and equity to intertwine and the danger that the courts will forget to respect the law side of the law-equity divide in exercising their equitable powers).

for that equitable review.[86] These are the very real concerns that caused the Delaware Supreme Court in *Alabama By-Products* to admonish the chancery court to use its equitable powers under *Schnell* sparingly: "equitable principles. . .must be exercised with great caution and restraint. Otherwise, the stability of Delaware law is imperiled."[87]

Although *Schnell* allows a court to invalidate, *per se*, *any* action, the vast majority of *Schnell* cases involve directors manipulating the voting mechanics to disenfranchise shareholders. Given the strong policy reasons for limiting *Schnell*, applying the doctrine only to cases involving voting mechanics, such as the manipulation of the date of the shareholder meeting or the advance notice requirements described above,[88] makes sense.[89] Limiting the area of conduct to which *Schnell* could apply would mean only that most fiduciary conduct would be

86. Jacobs, *supra* note 74, at 7, 9-15 (writing that the Delaware Supreme Court's shift away from equity is more of a "mid-course adjustment—an effort to create a 'bright line' around equity to enable practitioners and their clients to predict when otherwise legally valid corporate acts would become subject to equitable nullification").

87. 588 A.2d at 258 n.1 (overruling the Chancery Court, which had allowed evidence of unfair dealing to serve as the equitable basis for court's determination of the fair value of the stock in an appraisal proceeding, contrary to the rule that claims of unfair dealing cannot be litigated in appraisal proceedings); *see also* STAAR Surgical Co. v. Waggoner, 588 A.2d 1130, 1137 n.2 (Del. 1991) (discussing *Schnell* stating: "again, we emphasize that our courts must act with caution and restraint when granting equitable relief in derogation of established principles of corporate law."); Stroud v. Grace, 606 A.2d 75, 95-96 (Del. 1992) (reversing the Chancery Court and holding that since the statute delineates the required disclosure to effect a charter amendment, the court could not use its equitable powers under *Schnell* to expand those disclosure requirements); Nixon v. Blackwell, 626 A.2d 1366, 1379-81 (Del. 1993) (reasoning that since neither the statute nor the corporation's governance provisions required equal liquidity rights for all shareholders, the court could not use its equitable powers under *Schnell* to mandate equal liquidity).

88. *See supra* note 47 and accompanying text.

89. As discussed above, *supra* note 78 and accompanying text, what constitutes a voting mechanic is not always apparent. *Cf.* Portnoy v. Cryo-Cell Int'l, Inc., 940 A.2d 43, 67 (Del. Ch. 2007) (ordering a new election of directors and noting "in keeping with the traditional vigilance this court has displayed in ensuring the fairness of the coprorate elction process, and in particular the process by which directors are elected, purposely inequitable conduct in the accumulation of voting power will not be tolerated.").

judged by a flexible standard—presumably *Blasius*—rather than by a *per se* rule.

One quickly discovers, however, that the *Blasius* standard is flexible only in theory. Until the chancery court's recent decision in *Mercier v. Inter-Tel*,[90] no case finding that the *Blasius* review was triggered[91] had ever concluded that the directors had satisfied the compelling justification test.[92] Moreover, while *Mercier* is the first case to find the directors had satisfied the compelling justification test, the decision pays only lip service to that test. Instead, the chancery court in *Mercier* argued that the *Blasius* test "is so pejorative that it is more a label for a result than a useful guide to determining what standard of review should be used by a judge to reach an appropriate result."[93] Thus, the heart of the *Mercier* decision seeks to dismantle *Blasius*' compelling interest test in favor of a test, like *Unocal*, that calibrates the directors' conduct in a particular context.[94] Only because the chancery court recognized that it could critique but not overrule the compelling justification

90. 929 A. 2d 786 (Del. Ch. 2007).

91. The trigger for *Blasius* review is that the directors' primary purpose in taking the disputed action is to disenfranchise the shareholders. *See Blasius*, 564 A.2d at 659; *supra* note 69 and accompanying text.

92. *Mercier*, 929 A.2d at 810 (lamenting that the compelling justification standard remained, "and no decision ha[d], before today, found it satisfied"). *Cf.* Portnoy v. Cryo-Cell Int'l, Inc., 940 A.2d 43, 69 (Del. Ch. 2007) (articulating the perceived "difficulty of applying the compelling justification test articulated in *Blasius* in a manner that works sensible results"); *see also* Williams v. Geier, 671 A.2d 1368, 1376 (Del. 1996) ("Blasius' burden of demonstrating a 'compelling justification' is quite onerous, and is therefore applied rarely.").

93. *Id.* at 806.

94. *Mercier* advocated a reasonableness standard consistent with Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). 929 A.2d at 810-11. In *Unocal*, the Delaware Supreme Court held it would require directors to bear the burden of proving that they had reasonable rounds to believe a danger to corporate policy existed, and that their defensive tactic was a reasonable response to that threat. 493 A.2d at 955-58. Similarly, the Court in *Mercier* believed that the burden should be on the board to advance a legitimate corporate objective served by its decision. 929 A.2d at 810-11. That showing alone would not be sufficient, and "[t]o ultimately succeed, the directors must show that their actions were reasonable in relation to their legitimate objective, and did not preclude the stockholders from exercising their right to vote or coerce them into voting a particular way. If for some reason, the fit between means and end [was] not reasonable, the directors would also come up short." *Id.*

test,[95] did it reach a conclusion under the *Blasius* test that comports with the conclusion it had already reached applying the *Unocal* test, namely, that the directors' conduct was valid.[96] Reaching a uniform conclusion under both tests also allowed the court to demonstrate that a switch from *Blasius* to *Unocal* would not dilute the strong protection that the Delaware courts afford to voting rights.

Interestingly, while the chancery court in *Mercier* was attuned to *Blasius*' weaknesses, the court was not attuned to those same weaknesses in the *Schnell* doctrine, which it cited with approval.[97] Three examples will suffice to make this point. First, the court in *Mercier* criticized the *Blasius* test as being "not an actual means to make a decision," but a "post-hoc label."[98] Given that *Schnell per se* invalidates conduct based on the judge's intuitive feeling that the conduct is inequitable, the *Schnell* test is similarly a mere label, not an evaluation, of director conduct. Second, the court in *Mercier* described its modified *Blasius/Unocal* test as follows: "This test is a potent one that should not be used where traditional tools are available to police self-dealing or improperly-motivated director action."[99] But its modified *Blasius/Unocal* test is far less potent than *Schnell's per se* rule, which the court in *Mercier* cites with approval.[100] Finally, the court in *Mercier* tried to cabin the subject-matter applicability of *Blasius*: ". . .the reasoning of *Blasius* is far less powerful when the matter up for consideration has little or no bearing on whether the directors will continue in

95. *Id.* at 813 (stating that ignorance of Supreme Court decisions recognizing the compelling justification standard would be "impossible and inappropriate").

96. *Id.* at 819 (finding that the Inter-Tel board's purpose was not to disenfranchise its stockholders, but to give them more time to deliberate before exercising their right to vote. Because their acts did not preclude stockholders from "making a free and uncoerced choice about the Merger, [the] decision to reschedule the meeting does not invoke *Blasius* at all").

97. *Id.* at 805-06 (discussing that *Schnell's* standard "needed to be preserved. . . [and] applied in a more workable way than *Blasius* articulated").

98. *Id.* at 810.

99. *Id.* at 811.

100. Id. (discussing Wisconsin v. Peerless Sys. Corp., No. 17637, 2000 Del. Ch. LEXIS 170 (Del. Ch. Dec. 4, 2000) saying that if that court was concerned about improper adjournment, "a straight-forward finding of inequity under the principles articulated in *Schnell* could be made").

office."[101] The Delaware courts, however, have applied the even more powerful test of *Schnell* to contexts outside the election of directors, such as appraisal rights,[102] contract interpretation,[103] a successor insurance claim,[104] and cash-out mergers.[105] Indeed, the author of the *Mercier* opinion is also the author of *Pure Resources*, where the court invoked *Schnell* in a case involving a controlling-shareholder tender offer—a far cry from invoking *Schnell* to invalidate the directors' manipulation of the voting machinery to assure their own continuation in office.

Another recent case, *Portnoy v. Cryo-Cell Int'l, Inc.*,[106] highlights yet another concern about both *Schnell* and *Blasius* that courts had previously not articulated clearly: directors who violate either doctrine have also breached their duty of loyalty.[107] Curiously, when invalidating a board's actions under *Schnell* as inequitable, the Delaware courts fail to identify a corresponding breach of fiduciary duty.[108] *Hollinger Int'l, Inc., v. Black* [109]

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101. *Id.* at 808-09.

102. Berger v. Intellident Solutions, Inc., 911 A. 2d 1164, 1174 (Del. Ch. 2006) (reasoning that defendants' giving notice of meeting exactly within the ten-day statutory timeframe to prevent the plaintiffs from exercising appraisal rights "would appear to involve the kind of inequitable conduct *Schnell* meant to thwart").

103. Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099, 1106-07 (Del. 1985) (applying *Schnell* to invalidate defendant's claim that it was under no obligation to cash out remaining shareholders for price specified in acquisition agreement as that contract was limited to purchases effectuated within one year of the acquisition).

104. *Cf.* Del. Ins. Guar. Ass'n v. Christiana Care Health Servs., 892 A.2d 1073, 1077-78 (Del. 2006) (using *Schnell* in an insurance successor context to support the court's statement that it "goes without saying that a sham transaction designed simply to avoid [the statute in question] will not stand").

105. Seagraves v. Urstadt Prop. Co., 1989 Del. Ch. LEXIS 155, at *11-12 (Del. Ch. Nov. 13, 1989) (alleging de-listing of shares and the nonpayment of dividends in context of a cash-out merger were *Schnell* violations).

106. 940 A.2d 43 (Del. Ch. 2007).

107. *Id.* at 70-71 (commenting that "a good old-fashioned inquiry under precedent such as *Schnell*, . . . proscribes conduct that is disloyal in the well understood sense that it was undertaken not to advance corporate interests, but to entrench managers in office").

108. *E.g.*, *Lerman*, 421 A.2d at 912 (finding *Schnell* violation where advance-notice requirement exceeded time left until shareholder meeting, but not discussing any breaches of fiduciary duty). *But see Blasius*, 564 A.2d at 663 (insinuating that *Lerman* expressed "the concept of an unintended breach of the duty of loyalty").

is the only case purportedly applying *Schnell* to even mention fiduciary duties, obliquely stating that the disputed bylaws "complete a course of contractual and fiduciary improprieties."[110] When the board has acted so inequitably that its otherwise legal conduct is nevertheless invalidated under *Schnell*, however, a corresponding violation of the directors' duty of loyalty is implicit.[111] On the other hand, courts applying the *Blasius* have more readily acknowledged that "[t]he stringent standards of review imposed by. . .*Blasius* arise from questions of divided loyalty, and are well-settled."[112] This conclusion is true even if directors were acting in good faith, as they were in *Blasius*, because the determination that the directors had violated *Blasius*—that is, that their primary purpose was to disenfranchise the shareholders—conflicts with their fiduciary duty of loyalty.[113] Given the concomitant conclusion that directors have violated their duty of loyalty if they have violated either *Schnell* or *Blasius*, these directors will have liability that their

109. 844 A.2d 1022, 1080-81 (Del. Ch. 2004).

110. *Id.* at 1080 (stating that bylaw amendments effected by the controlling shareholder "were clearly adopted for an inequitable purpose and have an inequitable effect"). While the Chancery Court in *Hollinger* correctly noted a corresponding breach of fiduciary duty under *Schnell*, the Court's application of *Schnell* to any controlling shareholder action is debatable, as discussed below. *See infra* notes 122-129 and accompanying text.

111. For example, if directors selfishly try to protect their board positions, their actions, although legal, would violate the fiduciary duty of loyalty because its subset, the duty of good faith, encompasses both an actual intent to do harm as well as a conscious disregard for one's responsibility to act in the best interest of the corporation. *See, e.g.*, Twin Bridges L.P. v. Draper, No. 2351-VCP 2007 Del. Ch. LEXIS 136, at *80-81 (Del. Ch. Sept. 14, 2007) (likening the fiduciary duty of loyalty of corporate directors with that of a general partner to reason that *Schnell* violations would also violate the fiduciary duty of loyalty); Farahpour v. DCX, Inc., 635 A.2d 894, 901 (Del. 1994) (discussing, under *Schnell*, that "[t]he use of the corporate machinery, even in full compliance with Delaware law, does not insulate corporate management or directors from claims of inequitable conduct" with respect to directors' roles in conversion of non-profit non-stock company to for-profit stock company by bylaw amendment). *Cf. Stahl*, 579 A.2d at 1121-22 (Del. Ch. 1990) (stating that duty of loyalty violations do not require an "evil or selfish motive" and may occur even when directors are well-motivated and believe themselves to be acting in the best interests of shareholders).

112. Stroud v. Grace, 606 A.2d 75, 91-92 (Del. 1996).

113. *See* Wisconsin v. Peerless Sys. Corp., No. 17637, 2000 Del. Ch. LEXIS 170, at *27 (Del. Ch. Dec. 4, 2000) (characterizing *Blasius's* test as based on the duty of loyalty).

corporate charter cannot exculpate.[114] One would therefore expect these doctrines topically to cover only a narrow slice of fiduciary conduct before directors are exposed to liability by the inflexible, per se rule of *Schnell* or the demanding, compelling justification test of *Blasius.*

Finally, while the Delaware courts have been uncharacteristically hazy about the scope of the *Schnell* doctrine and the implications of a *Schnell* violation, they have been attuned to the fact that the *Schnell* doctrine should apply only on a case-by-case, fact-specific basis. As Vice Chancellor Strine explained, a court's creation of a *per se* rule of law is impermissible because it converts judges into legislators:

> a determination that a legally permitted action should be enjoined requires the court to find that there was a specific breach of an equitable duty. That does not necessarily mean that the judge must conclude that the directors acted for a disloyal purpose. But, at a minimum, it requires the court to articulate why the directors did not fulfill their fiduciary duties in the circumstances they confronted. The corollary to *Schnell* forbids end-running that job by declaring that what the directors did is, instead of being circumstantially inappropriate, in fact altogether forbidden because the judge believes that is the correct policy, rather than because the legislature has actually adopted that policy.[115]

In sum, the *Schnell* doctrine is precariously constructed: it has no topical boundaries, it results in a *per se* invalidation of legal conduct, and is based solely on the judge's view of whether that conduct was inequitable. Such a high-wire act demonstrates why most courts have used *Schnell* to invalidate,

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114. DGCL § 102(b)(7) does not allow for exculpation for breaches of the duty of loyalty or acts or omissions not in good faith.

115. Strine, *supra* note 85, at 904 and accompanying text. Vice Chancellor Strine used *NCS* as an example of a court incorrectly making a *per se rule* on equitable grounds. *Id.* (citing Omnicare Inc. v. NCS Healthcare, Inc., 818 A.2d 914 (Del. 2003)). *See infra* Part IV. "Fidelity to this corollary [to *Schnell*] requires the judiciary to eschew the formulation of per se rules in equity." Strine, *supra* note 85, at 883; *see also* Roland Int'l Corp. v. Najjar, 407 A.2d 1032, 1038 (Del. 1979) (Quillen, J., dissenting) (reasoning equitable decisions should not become a rule of equitable law that does not permit consideration of the facts specific to each case).

in a case-by-case basis, only *directors'* interference with *voting mechanics* that results in effective *disenfranchisement* of the shareholders. When considered against these boundaries, the court's use of the *Schnell* doctrine in *Pure Resource* is troubling.

Consistent with Delaware law, the court in *Pure Resources* stated that the *Schnell* doctrine could invalidate action even though that conduct was fully consistent with corporate law. After this traditional regurgitation of the doctrine, the court went on to make a remarkable statement: the *Schnell* doctrine rendered the doctrine of ILS irrelevant:

> The key inquiry is not what statutory procedures must be adhered to when a controlling stockholder attempts to acquire the rest of the company's shares. Controlling stockholders rarely trip over the legal hurdles imposed by legislation. *Nor is the doctrine of independent legal significance of relevance here.* That doctrine stands only for the proposition that the mere fact that a transaction cannot be accomplished under one statutory provision does not invalidate it if a different statutory method of consummation exists. *Nothing about that doctrine alters the fundamental rule that inequitable actions in technical conformity with statutory law can be restrained by equity.*[116]

Having made this bold pronouncement about the efficacy of the *Schnell* doctrine, it is arguable that the court did not apply *Schnell* as *Pure Resources* contains no further discussion of any inequitable conduct. Instead of using his broad equitable powers to invalidate legal conduct under *Schnell*, Vice Chancellor Strine instead defined what would constitute a non-coercive tender offer within the meaning of *Solomon.*[117] Therefore, having surfaced both the *Schnell* doctrine and the doctrine of ILS, Vice Chancellor Strine quickly buried them.

Given the contours of the *Schnell* doctrine, however, Vice-Chancellor Strine's invocation of *Schnell* in *Pure Resources* is nevertheless troubling. In *Pure Resources*, the defendant had empowered the shareholders to vote by allowing a majority of the minority shares to veto the transaction.[118] Therefore,

116. *In re* Pure Resources, Inc. S'holders Litig., 808 A.2d 421, 434 (Del Ch. 2002).
117. *See supra* note 38 and accompanying text.
118. *Pure Resources*, 808 A.2d at 430.

given that the vast majority of *Schnell* cases involve brazen attempts by directors to disenfranchise stockholders, *Pure Resources'* invocation of the *Schnell* doctrine seems disturbingly out of place.[119] Moreover, a going-private transaction is not topically similar to the paradigm *Schnell* case. Although target shareholders in a tender offer act akin to voting—that is, they "vote" by tendering their shares—they are not mechanically voting, and are not acting to elect directors. Furthermore, although there are a few cases in which the courts have applied the *Schnell* doctrine to actions by controlling shareholders,[120] the vast majority have been cases against directors, and rightfully so. The very premise of *Schnell* is that the directors are treading on hallowed ground when they interfere with shareholder voting rights.[121] Since *Schnell per se* invalidates directors' efforts to disenfranchise their shareholders, logically that doctrine is inapplicable to controlling shareholders because they certainly would not act to disenfranchise themselves. Arguably, those few cases that apply *Schnell* to controlling-shareholder transactions have erred,[122] and *Pure Resources'* invocation of *Schnell* in that context exacerbates this error.

For similar reasons, the *Blasius* doctrine is inapposite to controlling-shareholder transactions. Topically, *Blasius* applies to a board's efforts to entrench itself. Instead of viewing such director conduct with suspicion and requiring the board

119. *See supra* notes 46-47 and accompanying text. Similarly, the controlling shareholder in *Pure Resources* was not inequitably seeking to prevent shareholders from exercising appraisal rights; instead, the second-step short-form merger was required to offer these rights. *See Pure Resources*, 808 A.2d at 441-42 n. 39 and accompanying text; *see also supra* note 10 and accompanying text.

120. *E.g.*, Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1028-29 (Del. Ch. 2004) (invalidating, under *Schnell*, controlling shareholder's attempt to disable the board of a subsidiary); Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099, at 1106-07 (1985) (citing *Schnell* to invalidate controlling shareholder's attempt to avoid a contractual commitment to pay a higher price if it effected a freeze-out merger within a one-year period). *Cf.* Smith v. SPNV Holdings, Inc., Nos. 8395, 8080, 1987 Del. Ch. LEXIS 505, at *8-10 (Del. Ch. Oct. 28, 1987) (discussing that controlling shareholder's choice of timing in effecting a merger could implicate a *Schnell* violation); Frantz Mfg. Co. v. EAC Indus., 501 A.2d 401, 408-09 (Del. 1985) (finding no *Schnell* violation where majority shareholder had enacted restrictive bylaws to protect itself).

121. *See supra* note 46 and accompanying text.

122. *See also infra* Part III (discussing the proper way to monitor controlling shareholder transactions).

to prove a compelling justification for its actions, a court would instead need an evaluative monitor that considers the controlling shareholder's fiduciary duties and its concomitant right to take certain actions in its own self interest.[123]

This Article's contention that neither *Schnell* nor *Blasius* is applicable to controlling-shareholder transactions should not be understood as recommending a free pass for these transactions. The point is that the stringent rules of *Schnell* and *Blasius* are a poor fit for controlling-shareholder transactions, both topically and logically. Controlling shareholders, while classified as fiduciaries,[124] have incurred those responsibilities even though they bought a controlling bloc of stock because they believed it was in their own interests, not to serve others as fiduciaries normally do. As a result, courts must balance the legitimate desires of a controlling shareholder to realize the return from its investment with the fiduciary duties that the courts have bestowed on these shareholders. Such careful balancing is inconsistent with *Schnell's* and *Blasius'* inflexible rules. Therefore, courts should employ an evaluative monitor in controlling shareholder cases, as is inherent in a fiduciary analysis.

Examination of one of the leading controlling-shareholder cases that purports to use *Schnell* will demonstrate why these cases would be more appropriately monitored by the fiduciary duty of loyalty. In *Hollinger Int'l, Inc. v. Black*,[125] the controlling shareholder, International, was itself controlled by Conrad Black. Black sought to regain control over Hollinger after both Black and International committed a series of contractual and fiduciary breaches. International acted to amend Hollinger's bylaws to give it—and Black by proxy— veto power over the board's efforts to sell assets to rectify the harm caused by the breaches of Black's fiduciary duty of loyalty. Noting that the Delaware Supreme Court in *Frantz Mfg. Co. v. EAC Indus.*[126] made *Schnell* applicable to bylaws, the chancery court in *Hollinger* voided these bylaws under *Schnell*, observing that,

123. *See* Siegel, *supra* note 33, at 72-76 (discussing need for courts to balance controlling shareholder's fiduciary duties with their right to act in their own self interest).

124. *See id.* at 42 (discussing that "shareholders who control a transaction are required to act as fiduciaries").

125. 844 A.2d 1022 (Del. Ch. 2004).

126. 501 A.2d at 407-09 (Del. 1985).

"Although it is no small thing to strike down bylaw amendments adopted by controlling stockholder, that action is required here because those amendments complete a course of contractual and fiduciary improprieties."[127] The issue is not, however, whether *Schnell* applies to bylaws; instead, the issue is whether *Schnell* applies when a controlling shareholder adopts a bylaw not designed to disenfranchise shareholders.[128] Nor is the issue whether Black acted improperly; he clearly did, but *Schnell* was not the relevant doctrine to evaluate and remedy Black's breaches of fiduciary duty. Instead, rather than applying *Schnell*, the court should have evaluated this controlling shareholder's actions under the duty of loyalty, balancing the controlling shareholder's right to consider its own interests against these bylaw amendments which prevented the board from acting in the best interests of all shareholders, including those of the minority shareholders.[129]

Finally, as noted above,[130] while Vice Chancellor Strine wrote that a judge who uses the *Schnell* doctrine to create a *per se* rule of law is exceeding the scope of judicial authority by

127. *Id.* at 1081.

128. Similarly, it is arguable that controlling-shareholder cases that cite *Schnell—Rabkin, Smith* and *Singer*—have also erred. In *Rabkin* and *Smith*, the issue involved the controlling shareholder's timing in moving toward a merger. Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099, at 1103, 1106-07 (1985); Smith v. SPNV Holdings, Inc., 1987 Del. Ch. LEXIS 505, at *7-9. Minority shareholders claimed that the actions were inequitable and the courts both agreed, citing *Schnell. Rabkin*, 498 A.2d at 1106-07; *Smith*, 1987 Del. Ch. LEXIS 505, at *7-9. However, since the cases had nothing to do with the controlling shareholder disenfranchising the shareholders, the court should instead have considered whether these controlling shareholders violated their duty of loyalty. In Singer, minority shareholders objected to the attempt by a controlling shareholder to effectuate a freeze-out merger. Singer v. Magnavox Co., 380 A.2d 969, 979-80 (Del. 1977). Although the Court stated that a section 251 merger "made for the sole purpose of freezing out minority stockholders is an abuse of the corporate process" and found a violation of the fiduciary duty owed to minority shareholders, it still cited *Schnell* for the proposition that "Delaware case law clearly teaches that even complete compliance with the mandate of a statute does not, in every case, make the action valid in law." *Id.* at 975, 980.

129. *See, e.g.*, Young v. Valhi, 382 A.2d 1372, 1378-79 (Del. Ch. 1978) (citing *Schnell*, but enjoining merger proposed by controlling shareholder under a duty of loyalty theory, calling the shareholder's attempt to circumvent a charter provision protecting minority shareholders a "technically correct but devious corporate action.").

130. *See supra* note 115 and accompanying text.

acting like a legislator, arguably, that is precisely what he did in *Pure Resources.* In *Pure Resources,* he delineated four procedures that a controlling shareholder *must* fulfill in order to have its tender offer avoid being classified as coercive.[131] In so doing, the court moved beyond the facts of a specific case and instead created a *per se* definition of a non-coercive controlling-shareholder tender offer. Perhaps anticipating the argument that *Pure Resources* had crossed the law/equity line,[132] Vice Chancellor Strine contended in a footnote to an article that the case had not so transgressed. He argued that since the failure to follow the four steps in *Pure Resources* does not invalidate the transaction, but requires only that the controlling shareholder prove the transaction was fair to the minority shareholders, *Pure Resources* does not impermissibly cross the line.[133] Vice Chancellor Strine's defense of *Pure Resources* does not, however, withstand scrutiny. If a controlling shareholder has failed the *Pure Resources* test, the tender offer will be deemed coercive, thereby requiring the controlling shareholder to prove entire fairness. *Solomon's* holding that the controlling shareholder need not offer a fair price,[134] however, reduces the entire fairness test in this context to one of fair dealing.[135] It is difficult to imagine a judge determining that a coercive tender offer nevertheless constitutes fair dealing. As a result, *Pure Resources'* criteria necessary for a tender offer to qualify not as coercive becomes a *per se* rule.

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131. 808 A.2d at 444-46 (stressing that our law should consider an acquisition by a controlling stockholder non-coercive *only when:* (1) the acquisition is subject to a non-waivable majority of the minority tender condition; (2) the controlling stockholder promises to consummate a prompt DGCL § 253 merger at the same price if it obtains more than 90 percent of the shares; (3) the controlling stockholder has made no retributive threats; and (4) that the controlling stockholder allows the independent directors "free rein and adequate time to react to the tender offer").

132. *See* Strine, *supra* note 85, at n.109 (describing *Pure Resources* as an "illustration of the tendency of the law and equity boundaries to blur").

133. *See id.* (stating "Delaware courts have not erected a complete ban on consummating transactions without using the recommended procedural protections").

134. Solomon v. Pathe Commc'ns Corp., 672 A.2d 35, 39 (Del. 1996) (holding that although a controlling shareholder's tender offer cannot be coercive, it does not require a fair price).

135. Entire fairness consists of two prongs, fair dealing and fair price. Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983); *see supra* notes 11-30 and accompanying text.

II.
THE DOCTRINE OF INDEPENDENT LEGAL SIGNIFICANCE

In contrast to the equitable *Schnell* doctrine, the doctrine of ILS[136] is a rule of statutory construction. This rule validates a transaction that complies with one section of the statute even if the transaction could have proceeded under another statutory provision that provides an alternative process or different rights for shareholders.[137] In perhaps the most famous ILS case, *Hariton v. Arco Electronics, Inc.*,[138] the Delaware Supreme Court articulated and then applied the doctrine of ILS to validate the directors' choice to reorganize the corporation through a sale of assets, rather than through a merger, even though only the latter transaction would have afforded shareholders appraisal rights.[139] The Delaware Supreme Court endorsed the directors' choice:

> because the sale-of-assets statute and the merger statute are independent of each other. They are, so to speak, of equal dignity, and the framers of a reorganization plan may resort to either type of corporate mechanics to achieve the desired end. This is not an anomalous result in our corporation law.[140]

Several months after *Hariton*, the Delaware Supreme Court decided *Orzeck v. Englehart*,[141] a case, like the two-step going-private transaction, involving a purchase of stock fol-

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136. The doctrine of ILS is also sometimes referred to as the "equal dignity rule."

137. *See, e.g.*, Orzeck v. Englehart, 195 A.2d 375, 377 (Del. 1963) ("Action taken in accordance with different sections of that law are acts of independent legal significance even though the end result may be the same under different sections."). *See generally* D. Gordon Smith, *Independent Legal Significance, Good Faith, and the Interpretation of Venture Capital Contracts*, 40 WILLAMETTE L. REV. 825, 832-40 (2004) (tracing the history of the doctrine of ILS, the origins of which "lie in the Delaware common law"). For a detailed history of the doctrine of ILS, *see* C. Stephen Bigler & Blake Rohrbacker, *Form or Substance? The Past, Present, and Future of the Doctrine of Independent Legal Significance*, 63 BUS. LAW. 1 (2007).

138. 188 A.2d 123 (Del. 1963).

139. See Bigler & Rohrbacker, *supra* note 137, at 6-8, for the pre-*Hariton* case law, where the Delaware Chancery Courts developed the concept of the ILS doctrine without specific reference to the term "independent legal significance."

140. *Hariton*, 188 A.2d at 125.

141. 195 A.2d 375 (Del. 1963).

lowed by a short-form merger. The Court rejected plaintiff's claims that this two-step transaction was a *de facto* merger,[142] and instead validated the transaction with the following logic:

> While the argument made may have a surface plausibility, it nevertheless is contrary to the uniform interpretation given the Delaware Corporation Law over the years to the effect that action taken in accordance with different sections of that law are acts of independent legal significance even though the end result may be the same under different sections. The mere fact that the result of actions taken under one section may be the same as the result of action taken under another section *does not require that the legality of the result must be tested by the requirements of the second*

142. "*[D]e facto* merger occurs where one corporation is absorbed by another, but without compliance with the statutory requirements for a merger." William McIntyre, Note, *De Facto Merger in Texas: Reports of its Death Have Been Greatly Exaggerated*, 2 TEX. WESLEYAN L. REV. 593, 594 (1996) (citing Arnold Graphics Indus v. Independent Agent Ctr., Inc., 775 F.2d 38, 42 (2d Cir. 1985). *See also* Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 428 (2006) (explaining that if courts accept the *de facto* merger doctrine, "a transaction that technically was not structured as a merger but that had the same effect as one would be treated as a merger by the courts"). A "*de facto* merger" is generally structured as a sale of all assets, followed by a liquidation of the corporation. Since these two steps, when combined, have the same effect on shareholders as does a merger, shareholders claim that although the directors had not structured a transaction under the merger provision of the corporate statute, they had created its functional equivalent. Typically, this means that shareholders want appraisal and/or voting rights which accompany mergers but may not be offered in asset sales or purchases. A court's decision to treat a transaction as a *de facto* merger is therefore significant because shareholders may obtain rights otherwise unavailable.

It is important to note a few features of the *de facto* merger doctrine relevant to the discussion herein. The first is that unlike the doctrine of ILS, the *de facto* merger doctrine is grounded in principles of equity. Thus, "[t]o one court, a combination might be viewed as so functionally equivalent to a merger that voting and appraisal right provisions should be applied. . . . [but] [t]o a different court, the combined functions might not constitute a merger at all." *See* Stuart R. Cohn, *The Non-Merger Virtual Merger: Is Corporate Law Ready for Virtual Reality?*, 29 DEL. J. CORP. L. 1, 23, 26-27 (2004). Thus, the *de facto* merger doctrine can be seen as the polar opposite of the doctrine of ILS. *See* Velasco, *supra*, at 428-29 (declaring that the *de facto* merger doctrine is "utterly inconsistent with the equal dignity rule [the doctrine of ILS], which insists that the statutory requirements for a merger apply only to mergers and not to other legal transactions, such as asset purchases").

> *section.* . . . [T]he general theory of the Delaware Corporation Law is that action taken under one section of that law is legally independent, and its validity is not dependent upon, *nor to be tested by the requirements of other unrelated sections* under which the same final result might be attained by different means.[143]

Over the years, the Delaware Supreme Court has applied the doctrine of ILS to a variety of contexts where the statute gave a corporation a choice of routes by which it could proceed.[144] In addition, courts include within the ambit of the

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143. *Orzeck*, 195 A.2d at 377 (emphasis added); *see also* Farahpour v. DCX, Inc., 635 A.2d 894, 900 (Del. 1994) (stating that "the doctrine of independent legal significance provides that such action will not be tested by compliance with other sections of the [DGCL]"); Edelman v. Phillips Petroleum, No. 7899, 1985 Del Ch. LEXIS 459 (Del. Ch. Feb. 12, 1985) (stating that under the doctrine of ILS, a corporation has the option to choose which of two transactions to employ). *Cf.* Rauch v. RCA Corp., 861 F.2d 29, 31 (2d Cir. 1988) (rejecting plaintiff's reverse-*Hariton* argument that the merger should be recharacterized as a *de facto* liquidation). As the doctrine applies when there are two statutory alternatives, the doctrine was mistakenly raised in Louisiana Municipal Police Employees Retirement System v. Crawford, 918 A.2d 1172, 1192 (Del. Ch. 2007), *review refused sub nom.* Express Scripts, Inc. v. Crawford, No. 113, 2007 Del. LEXIS 101 (Del. Mar. 9, 2007), where the issue was whether a special dividend was part of the merger consideration, and in Gatz v. Ponsoldt, 925 A.2d 1265 (Del. 2007), where the issue was whether different transactions, once compressed, gave rise to a direct cause of action. *See* Bigler & Rohrbacker, *supra* note 137, at 13-15 (explaining how the doctrine of ILS was inapplicable to the facts of these two cases).

144. *See, e.g.*, Rothschild Int'l Corp. v. Liggett Group, Inc., 474 A.2d 133, 137 (Del. 1984) (holding the merger and liquidation pathways to be of equal dignity); Field v. Allyn, 457 A.2d 1089, 1098 (Del. Ch. 1983) *aff'd*, 467 A.2d 1274 (Del. 1983) (holding that statutory provisions for a cash-out merger and for a have also applied the doctrine of ILS. *See, e.g.*, Leonard Loventhal Account v. Hilton Hotels Corp., No. 17803, 2000 Del. Ch. LEXIS 149, at *34 (Del. Ch. Oct. 10, 2000) (using the doctrine to allow a corporation to enact a poison pill rights plan which met the requirements of sections 151 and 157 of the DGCL, rather than through a stockholder-approved amendment to the certificate of incorporation); Cutlip v. CBA Int'l, Inc., No. 14168 NC, 1995 Del. Ch. LEXIS 136, at *7-8 (Del. Ch. Oct. 27, 1995) (employing the doctrine of ILS to deny defendant-corporation's claim that shareholders lacked standing to file a derivative action following a cash-out merger because the plaintiffs-shareholders had filed the suit under section 220 of the DGCL prior to the merger, conferring standing, notwithstanding the fact that they were subsequently cashed-out of the corporation in the merger perfected under sections 228 and 251 of the DGCL); Warner Commc'ns Inc. v. Chris-Craft Indus., Inc., 583 A.2d 962, 970 (Del. Ch. 1989) (granting plaintiffs, who were potential merger candidates, a declaratory judgment that de-

doctrine those transactions that can be achieved either entirely or partially through a statutory route.[145] Thus, it is incontrovertible that the doctrine of ILS applies to a controlling shareholder's choice to pursue a going-private transaction through a tender offer/SFM, rather than through a long-form merger.

Although some criticize the doctrine of ILS for elevating form over substance,[146] Delaware courts nevertheless

fendants, preferred shareholders, were not entitled to a class vote under DGCL § 242 because the doctrine of ILS protected the corporation's right to proceed under § 251); *Edelman*, 1985 Del. Ch. LEXIS, 459, at *22-23 (applying the doctrine to reject plaintiff's claim that the corporation's recapitalization plan was really an unauthorized redemption of common stock, rather than an exchange of stock for stock, as authorized by DGCL § 151 (e)). *Cf.* Nixon v. Blackwell, 626 A.2d 1366, 1380-81 (Del. 1993) (applying the doctrine to preclude shareholders from opportunities that they might have had under the Delaware close corporate statutory provisions because the corporation had not been incorporated under this special section of the corporate statute).

145. Although tender offers are not a statutory transaction, the Delaware courts have applied the doctrine of ILS to those transactions. *See, e.g.*, *In re* Cox Commc'ns Inc. S'holders Litig., 879 A.2d 604, 623 (Del. Ch. 2005). There is a difference of opinion about whether the doctrine of ILS applies in other contexts, such as contract interpretation. *Compare* Elliott Assocs., L.P. v. Avatex Corp., 715 A.2d 843, 853 (Del. 1998) (using the doctrine of ILS to interpret an amendment to a corporation's certificate of incorporation, where the amendment used specific language from DGCL §251), *and Warner Commc'ns*, 583 A.2d at 970 (applying the doctrine of ILS to interpret the corporation's certificate of incorporation), *and* Smith, *supra* note 137, at 836 (citing the case of *Langfelder v. Universal Labs.*, 68 F. Supp. 209 (D. Del. 1946), which held that "a merger is of independent legal significance from the preferred stockholder's contractual rights"), *with* Bigler & Rohrbacker, *supra* note 137, at 12-13 (citing the Delaware Chancery Court opinion of *Noddings Inv. Group, Inc. v. Capstar Commc'ns., Inc.*, No. 16538-NC, 1999 Del. Ch. LEXIS 89 (Del. Ch. Apr. 9, 1999), for the proposition that the doctrine of ILS does not apply to issues of contractual interpretation). *Cf.* Benchmark Capital Partners IV v. Vague, No. 19719, 2002 Del. Ch. LEXIS 90 (Del. Ch. July 15, 2002), *aff'd*, 822 A.2d 396 (Del. 2003) (commonly known as an ILS case, but more appropriately described as a case of contract interpretation where the court considered the proper construction of a certification of incorporation).

146. *See, e.g.*, Bigler & Rohrbacker, *supra* note 137, at 15 (affirming that the doctrine of ILS, as compared to equitable principles, "exalts formalism"); Branson, *supra* note 84, at 94, 96 ("Moving beyond even art, Delaware has raised this phenomenon of corporate manipulation to the level of doctrine and christened it with a name: The equal dignity rule.") (criticizing the doctrine as a "a green light, signaling the Delaware courts' readiness to

staunchly support the doctrine[147] for two primary reasons. First, if the legislature creates two paths to the same end, the courts exceed their powers by favoring or invalidating one of those paths.[148] Second, to hold otherwise would require courts to identify the "true" substance of a transaction so that

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approve corporate transactions"); Smith, *supra* note 137, at 828 (analyzing the case of *Benchmark Capital Partners IV v. Vague*, concluding that *Benchmark* was decided on ILS grounds, and calling it a "dramatic" example of the Delaware court "elevating form over substance"). *But cf.* Uni-Marts, Inc. v. Stein, Nos. 14713, 14893, 1996 Del. Ch. LEXIS 95, at *28-29 (Del. Ch. Aug. 9, 1996) ("Delaware corporation law has sometimes been criticized for its reliance on formality. But the entire field of corporation law has largely to do with formality. . . . Formality has significant utility for business planners and investors.").

147. *See generally* Strine, *supra* note 85. Vice Chancellor Strine notes that the DGCL is "an enabling statute that provides corporate directors with capacious authority to pursue business advantage by a wide variety of means," *id.* at 879, and that "[t]he courts have long respected this ability to choose among the various methods for accomplishing a business transaction through judicial recognition of the doctrine of independent legal significance." *Id.* at 879 n.10 (citing *Williams*, 671 A.2d at 1381 n.29; Orzeck v. Englehart 195 A.2d 375, 377-78 (Del. 1963)); *see* Aronstam et al., *supra* note 22, at n.132 ("The doctrine [of independent legal significance] has become a keystone of Delaware corporate law and is continually relied upon by practitioners to assure that transactions can be structured under one section of the [DGCL] without having to comply with other sections which would lead to the same result.") (internal citations omitted); Leo E. Strine, Jr., *The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face*, 30 DEL. J. CORP. L. 673, 675 (2005) (endorsing the doctrine of ILS for giving directors flexibility and concluding that "the board may choose the less complicated and more certain transactional method . . . . [E]fficiency and flexibility are values that do not just serve the interests of corporate managers, they are also vital to stockholders"). *Contra* CAL. CORP. CODE §§ 181, 1100-1112, 1201-1203, 1300-1312 (West 2007) (attempting to eliminate distinctions in the availability of shareholder rights based on the form of the transaction).

148. *See Nixon*, 626 A.2d at 1377 (overturning the chancery court's decision holding that disparate treatment of employee and non-employee stockholders was unfair and stating that "[i]f such corporate practices were necessarily to require equal treatment for non-employee stockholders, that would be a matter for legislative determination in Delaware. There is no such legislation to that effect. If we were to adopt such a rule, our decision would border on judicial legislation."); Williams v. Geier, 617 A.2d 1368, 1385 & n.36 (Del. 1996) (noting in conclusion that, had the court not upheld the board's actions as permissible under the DGCL and the doctrine of ILS, but instead "engraft[ed]. . . an exception to the statutory structure and authority" in order to accommodate the plaintiff's argument, it would "be engaging in impermissible judicial legislation"); Branson, *supra* note 84, at 95 (stating

they could determine in which statutory provision the transaction best fits.[149] Such a process invites plaintiffs to sue in the hope that the court will recharacterize the transaction. Invariably, such litigation increases both the cost and difficulty of transactions.

There can be little debate that the doctrine of ILS and the *Schnell* doctrine are polar opposites[150]: judicial abstention versus judicial activism; form versus substance; certainty versus indeterminacy; deterrence versus encouragement of litigation; and *ex ante* planning versus *ex post* judicial resolution. Each doctrine assigns an entirely different role to the market and to courts.[151] The doctrine of ILS permits market solutions within the broad parameters of the corporate statute, while the *Schnell* doctrine permits judicial review and restructuring of those transactions.[152] If both doctrines intersect in a given fact-pattern, the resulting collision ought not be easily resolved. Nevertheless, as noted above, the court in *Pure Resources* held that while both doctrines were applicable to the going-private transaction at hand, the *Schnell* doctrine easily trumped the doctrine of ILS:

> *Nor is the doctrine of independent legal significance of relevance here.* That doctrine stands only for the proposition that the mere fact that a transaction cannot be accomplished under one statutory provision does not invalidate it if a different statutory method of consummation exists. Nothing about that doctrine alters the fundamental rule that inequitable actions in tech-

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that the legislature, not the courts, must decide the priority of statutory provisions).

149. The doctrine of ILS provides the further benefit of predictability and certainty to transactional planners and Delaware corporations. *See* Bigler & Rohrbacker, *supra* note 137, at 2 ("If corporate lawyers structure a transaction in a certain way, in a way compliant with one section of the DGCL, they can have comfort that the courts will not invalidate the transaction for its failure to comply with a different section.").

150. Branson, *supra* note 84, at 96 ("stating that "[w]ith *Schnell*, the Delaware Supreme Court created the antipode of the equal dignity rule.").

151. Smith, *supra* note 137, at 848-49 (observing that "these two doctrines imply different roles for markets, legislatures, [and] courts").

152. *Id.* at 848-49.

nical conformity with statutory law can be restrained by equity.[153]

For a variety of reasons, the court's phrasing and application of the doctrine of ILS in *Pure Resources* is troubling. At the outset, while the leading ILS cases, *Hariton* and *Orzeck*, phrase the doctrine as allowing the fiduciary to select between two statutory provisions which both authorize the transaction,[154] *Pure Resources* phrases the doctrine so as to permit the fiduciary to pursue a transaction under one statutory provision even if

153. *In re* Pure Resources, Inc. S'holder Litig., 808 A.2d 421, 434 (Del. Ch. 2002) (emphasis added) (citing Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971); *see also* Hollinger Int'l, Inc. v. Black, 844 A.2d 1022, 1077-78 (Del. Ch. 2004) ("In general, there are two types of corporate law claims. The first is a legal claim, grounded in the argument that corporation action is improper because it violates a statute, the certificate of incorporate, a bylaw or other governing instrument, such as a contract. The second is an equitable claim, founded on the premise that the directors or officers have breached an equitable duty that they owe to the corporation and its stockholders.").

154. Hariton v. Arco Elecs., Inc., 188 A.2d 123, 125 (Del. 1963) (recognizing that the sale-of-assets statute and the merger statute are "of equal dignity" and that a corporation may "resort to either type of corporate mechanic[ ]" to achieve the desired reorganization plan); *see also* Orzeck v. Englehart 195 A.2d 375, 378 (Del. 1963) (declaring that sections of the DGCL are legally independent and that the validity of one section is "not dependent upon, nor to be tested by the requirements of other unrelated sections under which the same final result might be attained by different means"); *In re* Cox Commc'ns, Inc. S'holder Litig., 879 A.2d 604, 623 (Del. Ch. 2005) (stating that Delaware's doctrine of independent legal significance allows corporations to take "a variety of transactional routes to the same destination"); Moran v. Household Int'l, Inc., 490 A.2d 1059, 1077 (Del. Ch. 1985) *aff'd*, 500 A.2d 1346 (Del. 1985) ("Under the doctrine of "independent legal significance" if an action can be accomplished under one section of the General Delaware Corporation Law it need not satisfy the requirements of another section which permits the same result."). *Cf.* Farahpour v. DCX, Inc., 635 A.2d 894, 900 (Del. 1994) (applying the doctrine of independent legal significance to permit a non-stock, non-profit corporation to convert into a for-profit, stock corporation under the DGCL § 242(b)(3), which allows amendment of the certificate of incorporation in such circumstances via resolution, and relieving the corporation of the obligation to comply with other sections of the DGCL); Giammalvo v. Sunshine Mining Co., No. 12842, 1994 Del. Ch. LEXIS 6, at *19 (Del. Ch. Jan. 31, 1994) (analogizing to the doctrine of independent legal significance to hold that directors could act under one provision of the corporation's certificate of incorporation without complying with others).

another provision would preclude the transaction.[155] This shift in phrasing has subtle but important implications. Given that *Schnell* is an equitable doctrine, one could imagine a court being more receptive to a plaintiff's complaint that describes fiduciaries doing an end-run around forbidden conduct than to a complaint alleging that the fiduciary pursued one of two

155. *See Pure Resources*, 808 A.2d at 434 (asserting that the doctrine of ILS "stands only for the proposition that the mere fact that a transaction cannot be accomplished under one statutory provision does not invalidate it if a different statutory method of consummation exists"); *see also* SICPA Holdings S.A. v. Optical Coating Lab., Inc., No. 15129, 1997 Del.Ch. LEXIS 1, at *13-14 (Del. Ch. Jan. 6, 1997), *reprinted in* 22 DEL. J. CORP. L. 1282 (1997) (calling the doctrine of independent legal significance an "elementary concept of Delaware corporation law" that "holds that legal action authorized under one section of the corporation law is not invalid because it causes a result that would not be achievable if pursued through other action under other provisions of the statute"); Singer v. Magnovox Co., 367 A.2d 1349, 1354 (Del. Ch. 1976) ("[I]t is well established that the various provisions of the Delaware General Corporation Law are deemed to have independent legal significance and that a result prohibited by action attempted under one section of the law may be entirely permissible when accomplished through the authorization of another"); Lewis v. Great W. United Corp., No. 5397, 1977 Del. Ch. LEXIS 171, at *3 (Del. Ch. Sept. 19, 1977) (stating that Delaware's doctrine of independent legal significance holds that "a result which might be unlawful if attempted under one section . . . may nonetheless be valid if accomplished under the authority of another section"); Bigler & Rohrbacker, *supra* note 137, at 19 (articulating two "formulations" of the doctrine: "The first applies when two statutory alternatives exist (A and B) that would legally reach the same result," and the corporation chooses between one of two permissible alternatives. Alternatively, the second formulation applies "when there are statutory alternatives each reaching the same end result, but where one (X) forbids the transaction and the other (B) allows the corporation to reach this end result through a different statutory method."); Branson, *supra* note 84, at 95 ("[T]he phrasing the doctrine to mean that "two statutory pathways [are] independent of each other so that a result may be accomplished by proceeding on a course of action under one section which is not possible, or even forbidden, under another."). *Cf.* Kumar v. Racing Corp. of Am., Inc., No. 12039, 1991 Del. Ch. LEXIS 75, at *25 n.1 (Del. Ch. Apr. 21, 1991) *reprinted in* 17 DEL. J. CORP. L. 274, 288 (1991) (deciding not to address plaintiffs' argument that, under the doctrine of ILS, the shares they sought to issue should be considered valid pursuant to DGCL § 157 as consideration for relinquishment of the right to receive future dividends, despite the fact that §170 prohibits such a stock issuance as a dividend under the circumstances); Baron v. Wolf, No. 4972, 1976 Del. Ch. LEXIS 180, at *5-7 (Del. Ch. Jan. 15, 1976) (holding that the doctrine of ILS permits defendants to proceed under DGCL § 160 in redeeming the corporation's stock, even though it could not legally meet the requirements of § 170 relating to dividends).

permitted tracks.[156] In other words, the court's negative phrasing of the doctrine of ILS may have primed it to embrace a *Schnell* argument. Second, and more importantly, *Pure Resources* declared the doctrine of ILS as not relevant to the going private debate because the *Schnell* doctrine makes strict compliance with the statute insufficient to validate the transaction.[157]

The court's labeling the doctrine of ILS as not relevant in *Pure Resources* is puzzling, given that a corporation's choice to engage in a two-step tender offer/SFM instead of a one-step merger is precisely the fact-pattern to which the doctrine applies.[158] In a subsequent going private opinion, *In re Cox Communications, Inc. Shareholders Litigation* (hereinafter "*In re Cox Communications*"),[159] Vice Chancellor Strine specifically stated that the doctrine of ILS permits controlling shareholders the choice of engaging in a two-step going- private transaction,

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156. *See* Winston v. Mandor, 710 A.2d 835, 841 (Del. Ch. 1997) (declaring that "whether statutory provisions defining the outer limits of a Delaware corporation's authority may be relied upon to avoid other statutory provisions placing limits on the manner in which those powers may be exercised, is an uncomfortable proposition").

157. *See supra* note 116 and accompanying text. While Vice Chancellor Strine stated that the doctrine of ILS was not relevant, he nonetheless conceded that the statutory method a controlling shareholder employed could be relevant to the court's ability to equitably review a transaction. *Pure Resources*, 808 A.2d at 434 (noting that "the structure and statutory rubric employed to consummate transactions are highly influential to courts shaping the common law of corporations"). Citing *Glassman v. Unocal Exploration Corp.*, 777 A.2d 242 (Del. 2001), Vice Chancellor Strine noted, for example, that the short-form merger statute precludes equitable review. *Id.* at n.14.

158. Searching for possible explanations as to why the doctrine could be irrelevant, one can ask whether it is because tender offers are not statutorily-sanctioned transactions. However, there are other cases that apply ILS to a transaction not explicitly sanctioned by the corporate statute. *See In re* Cox Commc'ns Inc. S'holders Litig., 879 A.2d 604, 623-24 (Del. Ch. 2005) (applying the doctrine of ILS to tender offers, which are not statutory transactions); *see also Giammalvo*, 1994 Del. Ch. LEXIS 6, at *19-20 (applying the doctrine of independent legal significance to interpret charter provisions); RGC Int'l Investors, LDC v. Greka Energy Corp., No. 17674, 2000 Del. Ch. LEXIS 157 at *45 (Del. Ch. Nov. 6, 2000) (even if a contract is not enforceable on its terms, it would have independent legal significance under the doctrine of promissory estoppel); *supra* note 144-45 and accompanying text (explaining that courts have also extended the doctrine of ILS to other, non-statutory transactions, such as tender offers and contract interpretation).

159. 879 A.2d 604 (Del. Ch. 2005).

rather than proceeding through a long-form merger.[160] The court's recognition of the doctrine of ILS in *In re Cox Communications* suggests that his labeling the doctrine in *Pure Resources* as not relevant was possibly just his selecting the wrong adjective; it is probable that the Vice Chancellor meant that the doctrine was not determinative of plaintiffs' claims, for immediately after he wrote that ILS was irrelevant, he wrote that *Schnell* required him to determine if the fiduciary's conduct was equitable.

Even assuming, *arguendo*, that the court had substituted the word "determinative" for "relevant," there is still much to be concerned about *Pure Resources'* cursory treatment of the doctrine of ILS. First, the court's quick dismissal of the doctrine of ILS did not give the doctrine the weight it deserved: fiduciaries *can* choose the form by which they proceed even when that choice negatively impacts on minority shareholders. The court in *Pure Resources* should have recognized that this doctrine, although not dispositive, does preclude a finding of a breach of fiduciary duty if the claim is based *solely* on the fact that fiduciaries chose one of the possible routes rather than another, and the route not chosen offers entire fairness. As the Delaware Supreme Court stated in *Orzeck*, "[t]he mere fact that the result of actions taken under one section may be the same as the result of action taken under another section does not require that the legality of the result must be tested by the requirements of the second section."[161] The inconsistency between the two transactions and the two remedies, however, is exactly what haunts the court in *Pure Resources.* Vice Chancellor Strine proclaimed that "[t]his disparity creates a possible incoherence in our law"[162] and "admit[s] being troubled by

160. *Id.* at 624 (holding that "controllers have . . . two different transactional methods to choose between in attempting to go private"). Vice Chancellor Strine continued to list a number of factors that may influence a controller's decision to pursue a long-form merger over a tender offer/sfm transaction, including "the controller's ownership stake, the extent of the public float, the presence of big holders, the desire for certainty and closure, and which route might yield the best price for it." For example, a controller with a minimal ownership percentage, far from the ninety percent requirement for a short-form merger, might find a long-form merger more attractive, while a controller with a much higher ownership interest may elect to pursue the more efficient tender offer/sfm. *Id.*

161. Orzeck v. Englehart, 195 A.2d 375, 377 (Del. 1963).

162. *Pure Resources*, 808 A.2d at 435.

the imbalance in Delaware law exposed by the *Solomon/Lynch* line of cases."[163] Subsequently, in *In re Cox Communications*, Vice Chancellor Strine reiterated his discomfort with deferring to the form of the transaction by stating that "the form of the transaction, *rather than any reasoned analysis*, apparently formed the implicit justification for the discrepancy" between the monitors of the two transactional routes.[164] In expressing his antipathy for the inconsistent monitors, the court seemed to ignore that prior ILS litigation in *Hariton* and *Orzeck* was precisely about whether two routes to the same end should afford identical remedies, with the Delaware Supreme Court unequivocally choosing form over substance. The court in *Pure Resources* should have done so as well or at least explained why the going-private context is different from other ILS cases.[165]

The second reason to suspect the court's quick dismissal of ILS was more than a word slip is that the court in *Pure Resources* used the *Schnell* doctrine as the omnipotent judicial tool—one capable of invalidating any transaction any fact pattern. The *Schnell* doctrine, however, usually does not negate the doctrine of ILS[166] for obvious reasons: choosing between

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163. *Id.* at 443.

164. 879 A.2d at 623 (emphasis added); *see also supra* note 146 (listing criticisms of the doctrine as elevating form over substance).

165. In light of Vice Chancellor Strine's opinion in *In re Cox Communications*, such a differentiation seems impossible to make. *See supra* note 160 (quoting Vice Chancellor Strine's language in the subsequent case of *In re Cox Communications*, where he held that the doctrine of ILS is indeed applicable to the going private context and the choice a corporate controller faces in determining whether to proceed with a long-form merger or a tender offer/sfm).

166. Of the twelve cases that cite both *Schnell* and ILS, *Pure Resources*, 808 A.2d 421, and *Esopus Creek Value, L.P. v. Hauf*, 913 A.2d 593 (Del. Ch. 2006), are the only two where the chancery court found that the actions of the board, while permissible under the DGCL, were nonetheless inequitable under *Schnell* so as to warrant invalidation.

> "The protections of the business judgment rule, when coupled with the doctrine of independent legal significance, provide a board with substantial discretion in determining the proper method by which to structure a material corporate transaction. *That discretion, however, remains bounded by fundamental principles of equity* that "necessarily limit what a board of directors can do" in its attempt to consummate such a transaction. *At the heart of this mandate lies the oft-cited axiom that "inequitable action does not become permissible simply because it is legally possible."* (citing Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971)) (emphasis added);

two permitted paths does not fit the paradigm *Schnell* case of directors manipulating corporate machinery to disenfranchise

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Esopus Creek Value, 913 A.2d at 603. *See also supra* note 116-117 and accompanying text (questioning whether the court in *Pure Resources* actually applied the *Schnell* doctrine, or also used its more general equitable powers). Thus, in the following cases, the court did not allow the *Schnell* doctrine to trump the doctrine of ILS: Applebaum v. Avaya, Inc. 812 A.2d 880, 886 (Del. 2002) (noting that the proposed transaction's disparate treatment of shareholders was permitted under the DGCL and that "[w]hile principles of equity permit [the] court to intervene when technical compliance with a statute produces an unfair result, [citing *Schnell,* 285 A.2d at 429] equity and equality are not synonymous concepts in the Delaware General Corporation Law") (citation omitted); Williams v. Geier, 671 A.2d 1368, 1384 n.35 (Del 1996) (declaring that "[a]ctions taken in strict compliance with a statutory scheme will generally not be disturbed by the Court, absent a showing of some inequitable conduct," and, finding no *Schnell*-type entrenchment motive or coercion present, the concluding that statutory compliance was sufficient.); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985) (defending the adoption of a poison pill rights plan using, *inter alia,* the doctrine of ILS and the business judgment rule, "which may restrict the scope of shareholder approval" without necessarily running afoul of *Schnell*). The remaining cases that cite both doctrines do so in passing, rather than actually applying either doctrine. *See, e.g.,* Grace Bros. v. UniHolding Corp., No. 17612, 2000 Del. Ch. LEXIS 101, at *46 (Del. Ch. July 12, 2000) (rejecting the directors' argument that ILS compelled the court to grant a motion to dismiss and instead using the doctrine of *Schnell,* stating that "[i]t was long ago settled that inequitable action is not insulated from review simply because that action was accomplished in compliance with the statutory and contractual provisions governing the corporation," and leaving the matter for the trial court to decide); Elliott Assocs., L.P. v. Avatex Corp., 715 A.2d 843, 846 n.9 (Del. 1998) (mentioning *Schnell,* but only to state: "We express no view of the application of *Schnell v. Chris-Craft Indus., Inc.*" and applying the doctrine of ILS to the merits of the case). Other courts apply the doctrine of ILS, but cite to *Schnell* only as a more general statement of the court's equitable powers. *See, e.g.,* Farahpour v. DCX, Inc., 635 A.2d 894, 900-01 (Del. 1994) (certifying an answer to the Court of Appeals for the District of Columbia, the Delaware Supreme Court concluded that the board's action in the proposed transaction was strictly in compliance with the provisions of DGCL §242, but added a final *Schnell* admonition, stating:

> "Strict adherence to the procedures authorized by particular provisions of the DGCL does not insure that the result will receive judicial approval in litigation initiated at the behest of disgruntled members or shareholders. *The use of the corporate machinery, even in full compliance with Delaware law, does not insulate corporate management or directors from claims of inequitable conduct*" (citing Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437 (Del. 1971)) (emphasis added).

shareholders.[167] *Pure Resources'* view that *Schnell* has unbounded coverage and power is clearly inconsistent with the concerns the Delaware Supreme Court articulated in *Alabama By-Products* that a wide-ranging use of *Schnell* could imperil the stability of Delaware law.[168] Moreover, evidence of inequitable conduct needed under *Schnell* should not be gleaned solely from a fiduciary's selection of one permitted route over another, as ILS permits.[169]

Not surprisingly, most of the Delaware case law supports a more limited view of the intersection between *Schnell* and the doctrine of ILS than does *Pure Resources.* Most cases that cite both doctrines resolve the conflict in favor of the doctrine of ILS.[170] Thus, in *Applebaum v. Avaya, Inc.,*[171] the Delaware Su-

167. *See* discussion *supra,* Part I, notes 46-64 (discussing the contours of the *Schnell* doctrine).

168. *See supra* notes 80-87 and accompanying text (delineating the policy concerns that motivated the Delaware Supreme Court in *Alabama By-Products Corp. v. Neal,* 588 A.2d 255 (Del. 1991), to caution restraint in applying the *Schnell* doctrine).

169. This is why court in *Blasius,* having determined that the directors were acting in good faith, could not apply the *Schnell* doctrine. Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 663 (Del. Ch. 1988) (concluding that the directors' actions, in good faith, were instead a violation of the directors' fiduciary duties of loyalty). It should be noted that while the *Schnell* doctrine looks to the fiduciary's intent, the doctrine of ILS looks neither at neither the fiduciary's intent nor at the effect of the chosen route. For example, in the case of *Warner Commc'ns Inc. v. Chris-Craft Indus., Inc.,* 583 A.2d 962 (Del. Ch. 1989), the court upheld the corporation's right to proceed with a merger under DGCL § 251 over plaintiffs' claims that they, as preferred shareholders, were entitled to a class vote under § 242. *Id.* at 970. The court did not consider the intent of the drafter of the preferred stockholders' certificate of designation, which outlines the rights of the preferred shares, relevant in coming to this conclusion; rather, it used ILS to infer the drafter's intent. *Id.* ("[I]t is extraordinarily unlikely that the drafters of Section 3.3(i) [of the designation], who obviously were familiar with and probably expert in our corporation law, would have chosen language so closely similar to that of [DGCL] Section 242(b)(2) [delineating specific circumstances in which a vote would be authorized, not including a merger] had they intended a merger to trigger the class vote mechanism of that section."); *see also* Smith, *supra* note 137, at 838-40 (examining the *Warner Commc'ns* case).

170. *See supra* note 166 (describing the Delaware cases considering both doctrines, where ILS prevails). For example, in *Williams v. Geier,* the Delaware Supreme Court refused to impose a majority of the minority vote, as required by DGCL § 144, because the recapitalization occurred under § 242 and was not inequitable to stockholders. 671 A.2d at 1384; *cf.* Edelman v. Phillips Petroleum, No. 7899, 1985 Del. Ch. LEXIS 459, *23 (Del. Ch. Feb.

preme Court permitted the corporation to eliminate fractional shares through a reverse stock split under Section 155 where the share value would be determined under that section, despite plaintiff's claims that it was inequitable to not calculate fair value in accordance with the appraisal provision in section 262.[172] Citing both *Schnell*[173] and the doctrine of ILS,[174] the court provided a logical reason that the two statutory sections could not have the same definition of fair value.[175] The court therefore held that *Schnell* was inapplicable because the proposed transaction was designed in good faith for a rational business purpose.[176] Not surprisingly, however, when the doctrines of ILS and *Schnell* collide in a voting case, the *Schnell* doctrine has more vitality. In *Esopus Creek Value L.P. v. Hauf*,[177] the Delaware Chancery Court applied the *Schnell* doctrine to invalidate the directors' choice of routes by which it could sell the corporation's assets.[178] The court held that the route cho-

12, 1985) (where, without explicitly citing *Schnell*, the court used its basic premise and rejected plaintiff's characterization of two-step transaction in technical compliance with the statute "as a form of 'sleight of hand' which misleads and manipulates," instead upholding the corporate action under ILS).

171. 812 A.2d 880 (Del. 2002).

172. *Id.* at 892-893. The plaintiff in *Applebaum* relied on a common maxim of statutory construction to make its argument: "[T]he same words used in different sections [of a statute] must be construed to have the same meaning." *Id.* at 892 (citing NORMAN J. SINGER, STATUTES AND STATUTORY CONSTRUCTION, § 51.02 (6th ed. 2000)).

173. *Id.* at 886 & n.8.

174. *Id.* at 892-93 & n.47.

175. *Id.* at 892-93. The Delaware Supreme Court found that "[t]he Court of Chancery correctly interpreted 'fair value' in Section 155 to have a meaning independent of the definition of 'fair value' in Section 262 of the Delaware General Corporation Law" in light of the different drafting timelines for the two statutory sections, historical case law, and the language of § 262(b)(2)(C) itself. *Id.* at 892.

176. Rejecting plaintiff's appeals to apply the rule of statutory construction which holds "that the same words used in different sections must be construed to have the same meaning," the court highlighted important differences between sections 155 and 252 and concluded based on the doctrine of ILS and *Hariton* that "[t]he Delaware General Assembly could not have intended Section 155(2) to have the same meaning as the fair value concept employed in Section 252." *Id.* at 892.

177. 913 A.2d 593 (Del. Ch. 2006).

178. In *Esopus Creek*, the board sought to complete an asset sale that, as a matter of Delaware law and under the corporation's certificate of incorporation, required the affirmative vote of a majority of the common shares. 913

sen, a proposed sale in a voluntary bankruptcy plan, "though technically within the letter of the law, works a profound inequity upon the company's common stockholders and is thus prohibited by the teachings of *Schnell*."[179]

In sum, properly applied, the doctrine of ILS would not be irrelevant to the *Pure Resources* litigation. To the contrary, the court should have deemed the doctrine not only relevant but also determinative that it must reject plaintiffs' demands for the entire fairness monitor simply because controlling-shareholder mergers trigger entire fairness review. A proper application of the doctrine of ILS would allow the controlling shareholder to choose its desired form of proceeding. Thus, *Schnell* should not have trumped the doctrine of ILS. To the contrary, *Schnell* should not have even been relevant to a controlling-shareholder transaction, and particularly one not involving a deprivation of voting rights. Concluding that the doctrine of ILS, not *Schnell*, should have been the relevant doctrine does not, however, give a free pass to this going-private transaction. Instead, the doctrine of ILS is probative that the controlling shareholder could proceed in this manner, but the controlling shareholder must also comply with its fiduciary duties.[180] As the court reasoned in *Roland International Corp. v.*

A.2d 593 (Del. Ch. 2006). However, the company was delinquent in its required reporting under the Securities Exchange Act of 1934. *See* 15 U.S.C. § 78n(c) (2000) (§ 14(c) of the Exchange Act) (explaining that the federal proxy regulations normally require that companies registered under the Act must distribute both an annual report and either a proxy statement or an information statement prior to calling such a shareholder meeting). *Esopus Creek*, 913 A.2d at 596. Because the company had no such annual report to distribute, it was barred from calling a meeting to put the asset sale to vote. "To circumvent this apparent dead end, the board of directors adopted a plan to file a bankruptcy petition once the asset sale agreement is signed, and thereafter seek approval of the sale from the bankruptcy court, without a meeting and without a vote by the common stockholders." *Esopus Creek*, 913 A.2d at 596.

179. *Esopus Creek*, 913 A.2d at 604 (finding the company was "financially healthy . . . [and] . . . simply delinquent in its SEC filing obligations" and that its sole motive for filing bankruptcy was to sell the assets of the company without complying with DGCL §271's vote requirement).

180. *See, e.g.*, Grace Bros. v. UniHolding Corp., No. 17612, 2000 Del. Ch. LEXIS 101, at *46 (Del. Ch. July 12, 2000) (stating that despite compliance with the statute, the doctrine of ILS will not insulate directors from liability if they breached their fiduciary duty of loyalty). *Grace Bros.* considered and denied a motion to dismiss, where minority shareholders of the UniHolding

Najjar,[181] the controlling shareholder's compliance with the statute only begins the court's analysis, which is completed only after an assessment of the fiduciary's compliance with its duties.[182] Thus, despite the distractions caused by its questionable use of the *Schnell* and ILS doctrines, the court in *Pure Resources* ultimately focused on the question regarding a controlling shareholder's fiduciary duties in a tender offer/SFM. The next section addresses this pivotal issue.

III.
FIDUCIARY DUTIES OF CONTROLLING SHAREHOLDERS

Imposing fiduciary duties on controlling shareholders may seem counter-intuitive, given that they do not buy their stock in order to act in anyone's best interest but their own.[183] Nevertheless, courts hold that controlling shareholders are fiduciaries to the minority shareholders.[184] The logic behind

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Corporation claimed that the UniHolding board of directors had breached its fiduciary duties when it permitted UniHolding's largest shareholder to take control of the corporation's primary asset–a fifty-four percent stake in the clinic laboratory, UniLabs Holding S.A. *Id.* Entertaining the arguments–of the plaintiffs' that the directors had acted inequitably under *Schnell* and from the defendants' that they were insulated by the doctrine of ILS–the court ultimately found the complaint adequately stated a claim for a breach of fiduciary duty sufficient to survive the motion to dismiss. *Id.* at *49.

181. 407 A.2d 1032 (Del. 1979).

182. *Id.* at 1036 (affirming that the law of fiduciary duty is independent of the statutory provisions of the DGCL and stating that "[d]ifferences between § 251 and § 253, in terminology or in procedure, do not alter the duty which exists apart from the procedures permitted by the [s]tatutes"). The *Roland* court continued to assert that "the short cut to merger afforded by the § 253 may not be used to short-circuit the law of fiduciary duty." *Id.*; *see also* Thorpe v. CERBCO, Inc., 676 A.2d 436, 444 (Del. 1996) (extending the doctrine of ILS to require that statutory provisions of the DGCL be given independent legal significance from a corporation's or director's fiduciary duties, such as the duty of loyalty); SICPA Holdings S.A. v. Optical Coating Lab., Inc, No. 15129, 1997 Del.Ch. LEXIS 1 (Del. Ch. Jan. 6, 1997), *reprinted in* 22 DEL. J. CORP. L. 1282, 1291 (1997) (stating that "fiduciary analysis is a different (supervening) level of analysis from legal analysis").

183. Siegel, *supra* note 33, at 33 n.26 (explaining that controlling shareholders do not fit the classic definition of a fiduciary, who acts primarily for the benefit of another, "since no one buys control to act in the best interest of others").

184. JEFFREY D. BAUMAN, ALAN R. PALMITER & FRANK PARTNOY, CORPORATIONS LAW AND POLICY 849 (6th ed. Thompson West 1994) (announcing

imposing fiduciary duties on controlling shareholders is rooted in the enormous power they have over the corporation: since they can elect and remove the board of directors, controlling shareholders arguably can influence transactions so as to skew them in their own best interests. For example, in a parent/subsidiary merger, minority shareholders are powerless to prevent the merger or change the terms of the transaction if neither board is independent of the controlling shareholder, and the controlling shareholder can produce the requisite majority approval from both corporations' shareholders. In that event, minority shareholders have only two options: they may demand their appraisal rights, if available,[185] or sue for equitable review of the transaction. Given that pursuing appraisal rights is unrealistic for those with small blocs of stock,[186] most minority shareholders in these controlling-

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that, "[w]ith power comes responsibility," and that fiduciary duties therefore extend to controlling shareholders); *see* Singer v. Magnavox, 380 A.2d 969, 977 (Del. 1977) (reasoning that controlling shareholders "owe their corporation and its minority shareholders a fiduciary obligation of honesty, loyalty, good faith and fairness"). It is important to note that while fiduciary duties are equitable in nature, the court's equitable review of a controlling shareholder's performance of its fiduciary duties is different from the equitable review the court performs under the *Schnell* doctrine. As discussed above, the *Schnell* doctrine applies largely to deliberate board actions to disenfranchise shareholders, such as moving or delaying a scheduled meeting date or manipulating an advance-notice provision to frustrate a proxy fight. *See infra* notes 46-47. That doctrine is more limited than is the fiduciary duty doctrine. As a result, a court should feel far more constrained when invalidating an action under the *Schnell* doctrine than it should in testing a fiduciary's compliance with its duties. *Schnell* is a wild card; fiduciary duties are not.

185. *See supra* note 15 (discussing the reasons why appraisal rights in Delaware may not be available in a particular merger).

186. *See* Green v. Santa Fe Indus., Inc., 533 F.2d 1283, 1297-98 & n.4 (2d Cir. 1976) (Mansfield, J., concurring) (asserting that only minority shareholders who own large blocs of stock find appraisal rights financially beneficial and that "it is generally agreed that they provide an unrealistic remedy") *rev'd on other grounds*, 430 U.S. 462 (1977). Some of the costs associated with seeking appraisal that are prohibitive for small-bloc owners of stock are "the many steps required to perfect appraisal rights, as well as high costs and expenses for attorneys and experts." Mary Siegel, *Back to the Future: Appraisal Rights in the Twenty-First Century*, 32 HARV. J. ON LEGIS. 79, 83 (1995); *see* Pellman v. Cinerama, Inc., 503 F. Supp. 107, 110 (S.D.N.Y. 1980) (stating that minority shareholders with only small ownership claims find appraisal rights economically unfeasible given the high costs for discovery, expert witnesses, and lawyers fees); Robert B. Heglar, Note, *Rejecting the Minority Dis-*

shareholder mergers are entirely dependent on the court's review of the controlling shareholder's compliance with its fiduciary duties.[187]

While courts hold controlling shareholders to the fiduciary standards required of directors,[188] unlike directors, controlling shareholders do not owe fiduciary duties in all contexts; they are entitled to some personal privileges attendant to having bought control.[189] For example, controlling shareholders can vote in their own self-interest as well as sell their

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count, 1989 DUKE L.J. 258, 271 & n.72 (1989) (describing the appraisal remedy as "unwieldy and costly" and noting that "[m]inority shareholders who seek an appraisal remedy risk accumulating a large bill for attorneys' fees and expert witnesses"); Joel Seligman, *Reappraising the Appraisal Remedy,* 52 GEO. WASH. L. REV. 829, 860 (1984) ("The cost provisions of appraisal statutes constitute a more substantial barrier to the initiation of an appraisal than do the procedures. The direct costs of an appraisal proceeding include court costs, costs of the appraiser, attorneys' fees, and costs of expert witnesses.").

187. Thus, the determination of whether a shareholder owes fiduciary duties to the minority shareholders is pivotal to that shareholder's obligations. The Delaware Supreme Court has held that "a shareholder owes a fiduciary duty only if it owns a majority interest in or exercises control over the business affairs of the corporation." Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344 (Del. 1987) (citing Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 958 (Del. 1985)); *see also* Siegel, *supra* note 33, at 34 (calling the decision of whether a minority shareholder is also a controlling shareholder "critical"). While no fixed percentage of stock will automatically transform a minority stockholder into a controlling stockholder with concomitant fiduciary duties, the standard for labeling someone as a fiduciary is the ability to dictate the terms of the transaction. Siegel, *supra* note 33, at 34-35; *see also* Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 70 (Del. 1989) ("A shareholder who owns less than fifty percent of a corporation's outstanding stocks does not, without more, become a controlling shareholder of that corporation, with a concomitant fiduciary status. For a dominating relationship to exist in the absence of controlling stock ownership, a plaintiff must allege domination by a minority shareholder through actual control of corporate conduct.") (internal citations omitted).

188. Singer v. Magnavox Co., 380 A.2d 969, 977 (Del. 1977) (quoting the definition of the duty of loyalty in *Guth v. Loft, Inc.,* 5 A.2d 503, 510 (Del. 1939), and stating that "[w]hile that comment was about directors, the spirit of the definition is equally applicable to a majority stockholder in any context in which the law imposes a fiduciary duty on that stockholder for the benefit of minority stockholders").

189. BAUMAN ET AL, *supra* note 184, at 849-50 (asserting that when shareholders have control, "their fiduciary duties are analogous to those of directors and officers, but different in subtle and important ways. . . . Although courts have looked to duties imposed on directors for guidance in reviewing

stock for a premium that they do not share with the minority stockholders.[190] Thus, the duties of controlling shareholders are contextual.[191] As noted above, in *Lynch* the Delaware Supreme Court held that the entire fairness monitor must govern controlling-shareholder long-form mergers, even when an independent committee negotiates on behalf of the minority shares and both a majority of the independent directors as well as a majority of the minority shares approve the transaction.[192] Subsequently, the Delaware Supreme Court explained its decision to require entire fairness review in all controlling shareholder mergers was warranted "because the underlying factors which raise the specter of impropriety can never be completely eradicated and still require careful judicial scrutiny."[193] The court in *Pure Resources* proffered *Lynch* as the dominant authority on controlling shareholder transactions, noting that "[t]he policy balance struck in *Lynch* continues to govern negotiated mergers between controlling stockholders and subsidiaries. If anything, later cases have extended the rule in *Lynch* to a broader array of transactions involving controlling shareholders."[194]

Having accepted that the entire fairness monitor has tentacles in a variety of controlling-shareholder transactions, *Pure Resources* then examined whether there are reasonable bases for the doctrinal inconsistency between the monitors for a controlling-shareholder merger and a controlling-shareholder

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the actions of controlling shareholders, there is no provision analogous to DGCL § 144").

190. Siegel, *supra* note 33, at 32-33 ("[S]hareholders who own a sizable percentage of stock have bought stock solely because they believed the purchase to be in their self-interest. Cognizant of this fact, courts have sanctioned the right of all shareholders to vote in their own interest and generally to retain the sole right to any control premium when they sell their stock.").

191. One leading article on controlling shareholders aptly described these fiduciary duties as determined by an "origami of judicial doctrines." Gilson & Gordon, *supra* note 11, at 786 .

192. *See* Kahn v. Lynch Commc'n Sys., 638 A.2d 1110 (Del. 1994); *supra* note 4 and accompanying text.

193. Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997) (citing Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983)).

194. *In re* Pure Resources, Inc., S'holders Litig., 808 A.2d 421, 437 (Del. Ch. 2002) (citing Emerald Partners v. Berlin, 787 A2d 85, 93, n.52 (Del. 2001); *Tremont Corp.*, 694 A.2d 422 at 428.

tender offer/SFM.[195] Having accepted *Glassman*'s analysis that the legislature implicitly precluded an equitable review of the short-form merger,[196] the court in *Pure Resources* focused its attention on the controlling-shareholder tender offer. Vice Chancellor Strine examined the structure of mergers and tender offers, as well as the statutory and common law roles for target directors in both transactions, in order to resolve a critical question: "Is there reason to believe that the tender offer method of acquisition is more protective of the minority, with the result that less scrutiny is required than of negotiated mergers with controlling stockholders?"[197]

Although noting that the controlling shareholder is on both sides of a negotiated merger and only on the offering side in the tender offer, Vice Chancellor Strine found that this "is not a wall that can bear the full weight of the *Lynch/Solomon* distinction"[198] because *Lynch*'s concern that the controlling shareholder might take retributive action if its offer is refused is of concern in both transactions.[199] Similarly, the court noted that the controlling shareholder's informational advantage is equally applicable in both mergers and tender offers.[200] Vice Chancellor Strine thus concluded that the two transactions are not so different as to warrant the very different monitors that *Lynch* and *Solomon* impose.[201] Furthermore, Vice Chancellor Strine found problematic the Delaware Su-

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195. *Pure Resources,* 808 A.2d at 439.
196. *Id.* at 437.
197. *Id.* at 441.
198. *Id.*
199. *Id.* ("[N]othing about the tender offer method of corporate acquisition makes the 800-pound gorilla's [the controlling shareholder's] retributive capabilities less daunting to minority stockholders."). The court in *Pure Resources* further explained, "many commentators would argue that the tender offer form is more coercive than a merger vote." *Id.* This is because in a merger vote, shareholders who vote against the transaction may still receive the merger consideration if the merger nonetheless prevails. On the other hand, in a tender offer, the non-tendering shareholder put herself in a precarious position by not tendering, if the offer for the tender offer for the rest of the shares is successful. If "[t]hat stockholder [is] one of the few who holds out, [she] leav[es] 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." *Id.* at 442.
200. *Id.* at 442-43.
201. *Id.* at 443.

preme Court's disparate views toward third-party tender offers and controlling-shareholder tender offers, ironically taking a more hands-off approach toward the controlling-shareholder offer even though it poses greater risks than does a third-party offer.[202]

Only after finding these inconsistent monitors intellectually untenable did the court in *Pure Resources* turn to the pivotal question: what are the fiduciary duties of controlling shareholders and target boards in the context of a controlling-shareholder tender offer?[203] Breaking with *Lynch,* Vice Chancellor Strine refused to expand that holding to controlling-shareholder tender offers, ultimately resting its decision on the important advisory role of an independent committee of target directors and the ability of informed and uncoerced minority shareholders to make their own investment decisions.[204] The court further argued that if there is to be movement to create symmetry between the two lines of cases, it should be *Lynch* that changes to a rule granting the controlling shareholder the protection of the business judgment rule if an independent committee of target directors and the majority of the minority shares approve the merger.[205] Thus, instead of conforming controlling-shareholder tender offers to the merger monitor, Vice Chancellor Strine took *Lynch*'s concerns about the capacity of a controlling shareholder to overreach and incorporated those concerns to fashion requirements necessary for such tender offers to qualify as "non-coercive" under *Solomon.*[206]

Intuitively, the court in *Pure Resources* concluded that *Lynch* had gone too far. While the court advocated re-examining *Lynch,* however, it did not go far enough. When one tugs on the filaments of *Lynch,* they reach back to *Weinberger.* In other words, *Pure Resources* missed a golden opportunity to critique not just *Lynch* but also *Weinberger* and its progeny on their core defect: their deviation from the teachings of *Sinclair Oil Corp. v. Levien,*[207] which held that *only* when controlling share-

202. *Id.* at 443-44.
203. *Id.* at 445.
204. *Id.* at 444.
205. *Id.* at 444 & n.43.
206. *Id.* at 445 & n.47.
207. 280 A.2d 717 (Del. 1971).

holders are self-dealing do they have to prove the entire fairness of their transaction.[208]

The plaintiff in *Sinclair* argued that when a controlling shareholder stands on both sides of the transaction, such conflict of interest itself trips entire fairness review. While the Delaware Chancery Court in *Sinclair* agreed with plaintiff's argument, the Delaware Supreme Court squarely *rejected* it:

> A parent does indeed owe a fiduciary duty to its subsidiary when there are parent-subsidiary dealings. However, *this alone will not* invoke the intrinsic fairness standard. This standard will be applied *only when the fiduciary duty is accompanied by self-dealing. . . .*"[209]

The Delaware Supreme Court in *Sinclair* then defined self-dealing as occurring if the parent "receives something from the subsidiary to the exclusion of, and detriment to, the minority stockholders of the subsidiary"; if there is self-dealing, then, and only then, must the parent prove the entire fairness of its transaction.[210]

Subsequently, the Court decided *Weinberger,* a case, like *Sinclair,* that involved a parent-subsidiary transaction. Without explanation, however, *Weinberger* simply assumed that a majority's control of both sides of the transaction subjected the transaction to entire fairness review.[211] Thus, *Weinberger's* holding that the conflict of interest itself trips entire fairness review is diametrically opposed to *Sinclair's* holding that the conflict alone will not trigger a heightened review.

208. *Id.* at 720.

209. *Id.* (emphasis added).

210. *Id.*

211. Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983). *Weinberger's* only reference to *Sinclair* was to cite the chancery court opinion in that case for the indisputable proposition that interlocking directors owe fiduciary duties to both corporations. *Weinberger,* 457 A.2d at 710 (citing Levien v. Sinclair Oil Corp., 261 A.2d 911, 915 (Del. Ch. 1969)). Ironically, had the court filtered the *Weinberger* facts through the *Sinclair* test, one could credibly argue that in any going-private transaction, the controlling shareholder has taken the corporation to the detriment and exclusion of the minority shareholders. If so, the court in *Weinberger* could have determined that the entire fairness test applied by being consistent with the *Sinclair* test, instead of ignoring it.

Shortly thereafter, the chancery court in *Citron v. E.I Du Pont de Nemours & Co.*[212] highlighted the inconsistency between *Weinberger* and *Sinclair*:

> The precise circumstances that will trigger the 'entire fairness' standard of review have not been consistently articulated in the Delaware cases. *Sinclair Oil Corp. v. Levien* holds that the plaintiff must demonstrate that the parent corporation stood on both sides of the transaction *and* have dictated its terms. However, *Bershad v. Curtiss-Wright Corp., Rosenblatt v. Getty Oil Co.,* and *Weinberger* indicate that to invoke that exacting review standard, all that is required is that the parent corporation have stood on both sides of the transaction.[213]

Despite *Citron's* attempt to showcase the clear discrepancy between *Weinberger* and *Sinclair*, subsequent courts continued to ignore *Sinclair* as *Weinberger* had done. After *Weinberger*, references to *Sinclair* surface in the Delaware case law only occasionally and then often in the wrong context.[214] *Weinberger* overwhelmingly—and without explanation—supplanted *Sinclair* as a threshold test for controlling-shareholder transactions. Thus, although the Delaware Supreme Court has never overruled *Sinclair*, *Sinclair's* virtual demise can be traced to *Weinberger*.[215] *Lynch's* inherent distrust of controlling-shareholder transactions is the natural extension of *Weinberger*.

212. 584 A.2d 490 (Del. Ch. 1990).

213. *Id.* at 500 n.13 (citations omitted).

214. *See* Siegel, *supra* note 33, at 59-65 (describing how, post-*Weinberger*, Delaware courts took one of several approaches in applying *Sinclair*). One such approach was to simply ignore *Sinclair's* threshold test and adhere to *Weinberger*, requiring the entire fairness monitor "whenever an enterprise transaction involved a controlling shareholder." *Id.* at 59; *see, e.g.*, Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997); *In re* MAXXAM, Inc., 659 A.2d 7610, 771 (Del. Ch. 1995). Another approach incorrectly "utilize[s] *Sinclair* as a basis for evaluating the fair dealing prong of entire fairness, rather than as a threshold strainer as it had been designed" by the Delaware Supreme Court. *See* Siegel, *supra* note 33, at 60; *see, e.g.*, Summa Corp v. Trans World Airlines. Inc., 540 A.2d 403, 406 (Del. 1988).

215. *See generally* Siegel, *supra* note 33 (tracing the development of the law governing controlling shareholders and concluding that the law has evolved, through *Weinberger*, away from its traditional roots, which require a more exacting inquiry to determine if and when an entire fairness review is warranted).

By creating a threshold test to identify self-dealing, the premise of *Sinclair* was, presumably, that either abuse by controlling shareholders is not inevitable, or that the costs of a routine fairness review outweigh the benefits.[216] Many noted scholars[217] and the Principles of Corporate Governance[218] similarly conclude that that all controlling-shareholder transactions should not automatically trigger a fairness review.[219] In taking the opposite position, *Weinberger* does not explain why a conflict of interest, by itself, should merit a fairness review in all cases.[220]

Cases subsequent to *Weinberger* presume a "specter of impropriety" from controlling-shareholder transactions that warrants a fairness review of those transactions.[221] *Sinclair*, however, implicitly challenges the assumption that there is a "specter of impropriety" that should require all controlling shareholder transactions to prove the fairness of the transac-

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216. *Id.* at 73. *Cf.* Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1486 (2005) ("A rule subjecting all transactions involving controlling stockholders to entire fairness review . . . could give rise to substantial nuisance litigation.").

217. *See, e.g.*, Gilson & Gordon, *supra* note 11; Siegel, *supra* note 33, at 72-80; *see also* Haas, *supra* note 5, at 2247-48 (arguing that "[t]he rationale[s] for subjecting controlling shareholder transactions to an entire fairness review . . . fail to justify the over-inclusive rule . . . that subjects virtually all controlling shareholder transactions to entire fairness," and proposing a safe harbor doctrine for controlling shareholder transactions based on the Model Business Corporation Act provisions dealing with interested director transactions).

218. PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS §5.10 cmt. e, at 328-29 (1994).

219. *Cf.* Odyssey Partners, L.P. v. Fleming Cos. Inc., 735 A.2d 386, 412 (Del. Ch. 1999) ("In theory, an entire fairness standard of review is appropriate where the controlling stockholder has *actually used* its power over the corporation 'to impair the normal and primary protection the law affords the corporation and its stockholders: the judgment of its independent board of directors.'") (internal citation omitted) (emphasis added).

220. *See* David B. Feirstein, *Parents and Subsidiaries in Delaware: A Dysfunctional Standard*, 2 N.Y.U. J.L. & BUS. 479, 500-05 (2006) (arguing that the two different standards of *Sinclair* and *Weinberger* do not "lead to meaningfully different outcomes in most circumstances," thus asserting that it is essentially immaterial whether courts are misapplying, or ignoring, *Sinclair's* threshold test because the ultimate result would be the same whether the court applied *Weinberger* or *Sinclair*).

221. *E.g.*, Kahn v. Tremont Corp., 694 A.2d 422 (Del. 1997).

tion, and instead limits the trigger of entire fairness only to those controlling-shareholder transactions where such shareholder is dealing with itself. A different phrasing explicates *Sinclair*'s point: does it make sense to require a controlling shareholder to have to defend the fairness of a transaction it did not control? In another context, the Delaware Supreme Court has held that a majority shareholder need not show the entire fairness of a transaction if it had truly ceded control. For example, in *Williams v. Geier*,[222] the Delaware Supreme Court, in an *en banc* decision, reasoned that even though there was a majority shareholder, plaintiff had not offered any evidence to show that the majority shareholder either dominated or controlled the board of directors:[223]

> The mere fact that the Family Group owned a dominant stock interest does not rebut the presumption of the business judgment rule or call the directors' independence into question. . . . If domination and control by a majority stockholder is not alleged by particularized facts and supported by evidence, the presumption of independence is intact.[224]

222. 671 A.2d 1368 (Del. 1996).

223. *Id.* at 1378.

224. *Id.* at 1378 n.22 (internal citations omitted); *see In re* Paxson Commc'n Corp. S'holders Litig., No. 17568, 2001 Del. Ch. LEXIS 95, at *22-23 (Del. Ch. July 10, 2001) (rephrasing the *Geier* court's language to state: "Even where the *potential* for domination or control by a controlling shareholder exists, the complaint must allege particularized allegations that would support an inference of domination or control") (emphasis in original); *cf.* Beam v. Stewart, 845 A.2d 1040, 1054 (Del. 2004) (dismissing a derivative action for failure to sufficiently plead the board's non-independence from the majority shareholder). *Compare* Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937-38 (Del. 1985) (reasoning, in the context of an entire fairness analysis, that the majority shareholder dealt fairly because it effectively ceded control so that the independent board was able to negotiate effectively), *and In re* Budget Rent A Car Corp. S'holders Litig., No. 10418, 1991 Del. Ch. LEXIS 29, at *12-13 (Del. Ch. Mar. 15, 1991), *reprinted in* 17 DEL. J. CORP. L. 220 (1992) (holding that the majority shareholder did not dictate the transaction because the transaction was ratified by a disinterested board of directors), *with In re* Digex, Inc. S'holders Litig., 789 A.2d 1176, 1207-14, 1211 (Del. Ch. 2000) (conducting an entire fairness review of the controlling shareholder's actions to waive DGCL § 203's prohibition on transactions with an interested shareholder by appointing a special committee of directors, who were "powerless to affect the [DGCL § 203 waiver] in any meaningful manner" because the controlling shareholder had not ceded control over the committee, thus, concluding that there was self-dealing present and that

Furthermore, the Delaware Supreme Court in *Geier* rejected plaintiffs' demand that the court apply a heightened monitor[225] to this transaction, holding instead that that when an independent board and stockholders approve a transaction, the standard is the business judgment rule.[226]

No doubt, the *Geier* facts can be distinguished from a controlling-shareholder tender offer/SFM in that the majority shareholder in *Geier* was not transacting business with the corporation; instead, the corporation proposed to amend its charter to effect a recapitalization plan that plaintiff argued would

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the transaction was not entirely fair). *See also In re* CompuCom Sys., Inc. S'holders Litig., No. 499-N, 2005 Del. Ch. LEXIS 145, at *34-37 (Del. Ch. Sept. 29, 2005) (applying the business judgment rule to the recommendation of the special committee of outside directors who negotiated the sale of a partially-owned subsidiary because the committee had independently selected and retained legal and financial advisors, had sufficient "independence to consider objectively whether the transaction was in the best interest of CompuCom and all of its shareholders," and there was no convincing evidence of self-dealing). Note, however, that the sale of a controlled subsidiary differs from a controlling-shareholder purchase because while all shareholders in a sale—including the controlling shareholder— have an interest in getting the highest price, the controlling shareholder's interest when it seeks to purchase the stock of the remaining shareholders is diametrically opposed to their interests. Although *CompuCom* involved the sale of a subsidiary, a conflict-of-interest arose: as the controlling shareholder owned both some common and all of the preferred stock, its interests diverged from the other common shareholders in that the controlling shareholder could arguably try to divert some of the purchase price to the preferred stock.

225. In *Geier*, the plaintiff argued to the Delaware Supreme Court that the heightened *Blasius* standard, rather than the *Unocal* test which the chancery court applied, should govern the case. *Geier*, 671 A.2d at 1376. As this Article explains above, *Blasius* imposes the most stringent standard of review when a plaintiff establishes that the board acted for the primary purpose of thwarting the exercise of a shareholder vote. If such burden is met, then the board of directors has the burden to demonstrate a compelling justification for its actions. *See supra* notes 71-76 and accompanying text (explaining the *Blasius* compelling justification standard). The *Unocal* test is also a heightened monitor that governs defensive tactics undertaken by a board in response to a hostile acquisition attempt, and is used "only when a board unilaterally (*i.e.*, without stockholder approval) adopts defensive measures in reaction to a perceived threat." *Geier*, 671 A.2d at 1377. The Delaware Supreme Court rejected the applicability of both of these monitors to the facts in *Geier*, holding that "neither standard [was] implicated . . . because there was no unilateral board action." *Id.* at 1376.

226. *Geier*, 671 A.2d at 1377. Note that in *Geier*, the controlling shareholders dominated the voting, *i.e.*, the transaction was not structured to permit a majority of the minority shares to veto the transaction.

benefit the majority and disfavor the minority shareholders.[227] In addition, while the *Geier* recapitalization involved an organic change, it was not an "end-game transaction" whereby shareholders would be cashed out of the corporation as they would in a going private transaction. One can certainly advocate that different threshold tests should apply depending on the importance of the transaction.[228] But the important teaching of *Geier* that transcends that fact pattern is that the Delaware Supreme Court was willing to trust the decision of an independent board even when a controlling shareholder exists.[229] The Delaware Supreme Court has repeated that teaching in many other contexts. For example, *Aronson v. Lewis*[230] and *Unocal Corp. v. Mesa Petroleum Co.*, [231] stifled any queasiness about whether courts will recognize that directors can be independent even when the corporation has a controlling shareholder, and *Weinberger* itself gave the stamp of approval to the efficacy of an informed vote of the majority of the minority shares.[232] If there is any reason that the controlling-shareholder going-private context should deviate from these landmark Delaware precedents, the courts have not so explained.

Furthermore, use of the business judgment rule in controlling-shareholder transactions where the controlling shareholder is not self-dealing should be disquieting only to the ex-

227. *Id.* at 1370.

228. *See* Siegel, *supra* note 33, at 75 (concluding that all "ownership-claim transactions," which include transactions such as stock issuances, redemptions, cash outs, reverse stock splits, and mergers, should undergo the heightened fairness review). Alternatively, the *Sinclair* threshold test should apply to controlling shareholder "enterprise claims," defined as operational issues which are normally matters of reasoned business judgment, to "evaluate which of this much larger group of transactions warrant in-depth scrutiny." *Id. See also* Bayless Manning, *Reflections and Practical Tips on Life in the Boardroom After* Van Gorkom, 41 BUS. LAW. 1, 5 (1985) (first articulating the difference between "enterprise" and "ownership" issues).

229. *Geier*, 671 A.2d at 1368, 1378 n.22.

230. 473 A.2d 805 (Del. 1984).

231. 493 A.2d 946 (Del. 1985).

232. Weinberger v. UOP, Inc., 457 A.2d 701(Del. 1983); *see also* Mary Siegel, *Tender Offer Defensive Tactics: A Proposal for Reform*, 36 HASTINGS L.J. 377, 406-08 (1985) (discussing *Weinberger* and explaining why "[t]he court in *Weinberger* placed the burden of proving fraud or unfairness on the plaintiffs if the freeze-out was approved by an informed vote of the minority shareholders").

tent that one lacks confidence that the judicial criteria for director independence or the requirements to assure integrity in the shareholder franchise are meaningful. Thus, *Pure Resources* helpfully fine-tuned standards for director independence and effective shareholder voting in the controlling-shareholder tender offer context.[233] But once that calibrating is done and the controlling-shareholder tender offer meets those standards, the business judgment rule should operate because the controlling shareholder is no longer dealing with itself. Even if the test for what constitutes self-dealing varies with the context,[234] *Sinclair's* premise that some threshold test should serve as a condition precedent to the entire fairness monitor is compelling and has roots in the Delaware case law.

In the context of a controlling-shareholder tender offer, when controlling shareholders effectively cede control to the target directors and the minority shares, controlling shareholders are not "taking to the detriment and exclusion" of the minority shareholders; they are, in fact, not taking at all as they are simply offering to buy stock. As *Pure Resources* reasoned, independent and well-informed directors can advise the uncoerced minority shareholders who can make their own investment decisions when the offer is conditioned on receiving a majority of minority shares. *Sinclair* would allow the business judgment rule to monitor a controlling-shareholder tender offer that had been structured so as to cede control effectively. *Pure Resources* correctly reached that same conclusion although by a different route.

Therefore, if the court reconsiders just *Lynch,* it is looking only at the tip of the iceberg. The element of *Weinberger* that imposes the entire fairness monitor in every controlling-shareholder transaction should be reviewed as well. *Pure Resources*

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233. *See supra* note 39 and accompanying text (outlining the *Pure Resources* requirements that a controlling shareholder must meet in order to avoid classification of his tender offer as "coercive").

234. In the "origami of judicial doctrines" regarding fiduciary law, one might posit for different threshold tests in different contexts, such as enterprise or ownership transactions. *See, e.g.*, Siegel, *supra* note 33, at 75 (describing a possible spectrum of threshold monitors for controlling shareholder enterprise transactions, with *Sinclair* at one end and *Weinberger's* minimal test of "simply standing on both sides of the transaction" at the other end); *supra* note 228 (explaining the argument for different threshold tests, depending on the form of transaction).

thus missed an opportunity to clarify the law on controlling shareholders: should *Sinclair*, or some other threshold test, apply before a controlling shareholder must defend the entire fairness of a transaction? Phrased differently, the Delaware Supreme Court ultimately must decide whether entire fairness scrutiny is triggered by the *Weinberger* premise—a controlling shareholder standing on both sides of a transaction—or by the *Sinclair* premise—only when a controlling shareholder is first found to be self-dealing.

IV. CONCLUSION

Pure Resources invoked three doctrines to assess the legality of a controlling-shareholder going private transaction effectuated by a tender offer and short-form merger. Careful consideration of these three doctrines should have made *Schnell* irrelevant, ILS probative,. and the controlling shareholder's duty of loyalty determinative. Unless the Delaware Supreme Court decides that the *Schnell* doctrine permits courts to invalidate, *per se*, *any* conduct by *any* fiduciary, the doctrine should have been deemed inapplicable to the transaction at hand for two reasons: one, the doctrine should apply only to directors, rather than to all fiduciaries; and two, the doctrine should be topically limited to efforts by directors to manipulate mechanical aspects relating to shareholder voting that effectively disenfranchise shareholders. *Schnell*'s underlying concerns about requiring fiduciaries to act equitably should instead be incorporated into the court's evaluation of whether the controlling shareholder fulfilled its fiduciary duties.

Unfortunately, instead of dismissing the *Schnell* doctrine, the court in *Pure Resources* empowered it so as to make the doctrine of ILS irrelevant. As a result, the doctrine of ILS, which permits a controlling shareholder to selects its choice of routes, did not get its due import. Had *Pure Resources* faithfully followed the doctrine of ILS, the court would not have needed to harmonize monitors for controlling-shareholder tender offers and controlling-shareholder mergers or found itself struggling with the incongruent judicial treatment of these transactions. A proper application of the doctrine of ILS would have made it irrelevant that *Lynch* required controlling-shareholder mergers to be monitored by entire fairness. Instead, the doctrine of ILS should have focused the *Pure Resources* court on the sole remaining issue: despite being permitted to choose the form of its transaction under the doctrine of ILS, did this controlling shareholder violate its fiduciary duties?

In evaluating this pivotal question, the court in *Pure Resources* focused on the inconsistent monitors between the long-form merger and the tender offer/SFM. Vice Chancellor Strine's analysis of *Lynch,* however, should not have been for purposes of uniformity in monitoring going private transactions—ILS, properly applied, would have disposed of that need—but for guidance about how a controlling shareholder could cede control so that it was not self-dealing. In other words, the court should have looked at *Lynch* not to create symmetry in going-private doctrine, but to create harmony in the law of controlling-shareholder transactions: when should a vote by a majority of minority shares and/or a vote by independent directors be sufficient to determine that a controlling shareholder is no longer in control of its transaction so that it is not self-dealing under *Sinclair*? Once the court identified the elements necessary for a controlling-shareholder tender offer to be deemed non-coercive and applied them to this offer, there were no further claims to be made against *this* controlling shareholder.

Pure Resources thus missed its chance to identify how *Weinberger* and *Lynch* had, without explanation, strayed from *Sinclair.* Intuitively, Vice Chancellor Strine reached a *Sinclair*-like conclusion: all controlling shareholder transactions should not be monitored by entire fairness. *Pure Resources* was correct that *Lynch* was useful—because it helped identify the need for protective devices to assure that the controlling shareholder is not in control—but *Lynch* was ultimately unconvincing regarding the proper standard of review. In contrast to *Lynch, Pure Resources* recognized that when those protective devices are in place, the business judgment rule should apply because a target board can be independent and minority shareholders can truly exercise free choice.[235] The holding in *Pure Resources*

235. *Compare* Kahn v. Lynch Commc'n Sys., Inc., 638 A.,2d 1110, 1117 (Del. 1994) ("Lynch I"), *aff'd,* Kahn v. Lynch Commc'n Sys., Inc., 669 A.2d 79 (Del. 1995) ("Lynch II") (confirming that the entire fairness monitor is the "exclusive standard of judicial review" for interested transactions), *with In re* Pure Resources, Inc., S'holder Litig., 808 A.2d 421, 444 (Del. Ch. 2002)

thus has great precedential value in going-private doctrine, but it is predicated on Vice Chancellor Strine's strong instincts, rather than on a consistent application of doctrine.

Finally, identifying the appropriate way to analyze a controlling-shareholder tender offer does not dispose of all the litigation issues. Apart from analyzing the fiduciary duties that controlling shareholders owe, the court in *Pure Resources* correctly reviewed whether the target directors fulfilled their fiduciary duties in this transaction.[236] In so doing, the court in *Pure Resources* delineated the respective duties that each owed; the controlling shareholder:

(opining that the holding of *Lynch I* should be altered to permit application of the business judgment rule where an independent committee of directors and majority of the minority shareholders each approve an interested transaction, believing in the ability of an independent directorship and an uncoerced minority shareholder to make appropriate investment decisions). The *Pure Resources* court continued to explain its preference for the *Solomon v. Pathe Commc'ns Corp.*, 672 A.2d 35 (Del. 1996), standard of review, see *supra* note 8, over that of *Lynch*:

> [T]he preferable policy choice is to continue to adhere to the more flexible and less constraining *Solomon* approach, while giving some greater recognition to the inherent coercion and structural bias concerns that motivate the *Lynch* line of cases. Adherence to the *Solomon* rubric as a general matter, moreover, is advisable in view of the increased activism of institutional investors and the greater information flows available to them. Investors have demonstrated themselves capable of resisting tender offers made by controlling stockholders on occasion, and even the lead plaintiff here expresses no fear of retribution. This does not mean that controlling stockholder tender offers do not pose risks to minority stockholders; *it is only to acknowledge that the corporate law should not be designed on the assumption that diversified investors are infirm but instead should give great deference to transactions approved by them voluntarily and knowledgeably.*

Pure Resources, 808 A.2d at 444. (emphasis added).

236. *Pure Resources*, 808 A.2d at 445; *see also* Rosenblatt v. Getty Oil, 493 A.2d 929, 939 (Del.1985) (differentiating between the duties of target directors and the more limited fiduciary duties of the majority shareholder). The Delaware Supreme Court explained that "[t]he sole basis for [its] conclusions in *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983), regarding the nondisclosure of the . . . report was because Signal[, the majority shareholder,] appointed directors on UOP's board, who thus stood on both sides of the transaction [and] violated their undiminished duty of loyalty to UOP. It had nothing to do with Signal's duty, as the majority stockholder, to the other shareholders of UOP." *Id.*

> owes a duty to permit the independent directors on the target board both free rein and adequate time to react to the tender offer, by (at the very least) hiring their own advisors, providing the minority with a recommendation as to the advisability of the offer, and disclosing adequate information for the minority to make an informed judgment. For their part, the independent directors have a duty to undertake these tasks in good faith and diligently, and to pursue the best interests of the minority.[237]

Thus, while controlling shareholders and directors are both fiduciaries, Vice Chancellor Strine correctly identified their respective—and different—duties in this transaction.

The bottom line is that *Pure Resources* reached the right conclusion but its route to that conclusion merits review. Beyond the law governing going-private transactions, the court's questionable application of the doctrines of *Schnell* and ILS could have negative implications in other contexts. The court's application of *Schnell* to a going-private transaction by a controlling shareholder is far beyond this doctrine's proper scope. Moreover, since *Pure Resources* created a *per se* rule in equity, it has exacerbated the tension between law and equity, turning what should be a fact-specific situation into a virtual legislative rule. Furthermore, if the doctrine of ILS can be dismissed as readily as it was in *Pure Resources,* it has no import. Instead, while not conclusive of the propriety of the transaction, the doctrine should have great probative value. Finally, *Pure Resources* missed the chance to explain the broader implication of its holding: controlling shareholders need not show entire fairness if they are not self-dealing. As a result, the court once again missed the chance to resurrect *Sinclair* from its virtual grave dug by *Weinberger.*

237. *Pure Resources,* 808 A.2d at 445.