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Conflicted Merger Transactions: Consolidating the Standards of Review

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Abstract

Mergers are structured in a variety of ways, in keeping with the underlying purpose of the transaction. While this structural flexibility is beneficial from a financial standpoint, it has resulted in varied interpretations of the case law surrounding the standards of review that govern conflicted merger transactions. Where there is no apparent conflict of interest between the board of directors of a corporation and the corporation's shareholders, the courts have traditionally accorded the board deference under the lenient business judgment rule. On the other hand, where there is a direct conflict of interest, the board is required to show the entire fairness of the transaction. However, conflicted transactions that fall in-between these two extremes have been reviewed in mixed ways, ultimately resulting in shifts between the two standards of review. This Note argues that there already exists an intermediate standard of review, the enhanced scrutiny standard, which appropriately addresses the potential underlying conflicts of interest in such transactions. This Note calls for the application of the enhanced scrutiny standard to all conflicted merger transactions regardless of their structure, which would clarify existing law and provide a uniform standard of review.

KEYWORDS: Conflicted Merger Transactions: Consolidating the Standards of Review

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Mergers are structured in a variety of ways, in keeping with the underlying purpose of the transaction. While this structural flexibility is beneficial from a financial standpoint, it has resulted in varied interpretations of the case law surrounding the standards of review that govern conflicted merger transactions. Where there is no apparent conflict of interest between the board of directors of a corporation and the corporation's shareholders, the courts have traditionally accorded the board deference under the lenient business judgment rule. On the other hand, where there is a direct conflict of interest, the board is required to show the entire fairness of the transaction. However, conflicted transactions that fall in-between these two extremes have been reviewed in mixed ways, ultimately resulting in shifts between the two standards of review. This Note argues that there already exists an intermediate standard of review, the enhanced scrutiny standard, which appropriately addresses the potential underlying conflicts of interest in such transactions. This Note calls for the application of the enhanced scrutiny standard to all conflicted merger transactions regardless of their structure, which would clarify existing law and provide a uniform standard of review.

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Introduction

This Note addresses the varying standards of review for mergers, which exist due to the myriad methods of negotiating such transactions. While the landmark cases *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) addressed the standards of review applicable in instances where the board of directors faced the threat of a hostile takeover, they did not address the level of scrutiny placed on a board in other instances.

Several cases since then have narrowly addressed the issue, but each case is an isolated example of the level of care a board of directors must assert in a particular transaction. In *Kahn v. Lynch Communication Systems, Inc.*, 638 A.2d 1110 (Del. 1994), the court required a review under the entire fairness standard. The Delaware Chancery Court in *In re Pure Resources, Inc., Shareholders Litigation*, 808 A.2d 421 (Del.

Ch. 2002) further parsed the different standards of review based on whether the merger was a result of a negotiation or a tender offer.

However, there still exists a lack of clarity as to whether the standard of review for a conflicted merger should be the entire fairness standard, the business judgment rule, or enhanced scrutiny. Configuring the standards of review based on the structural elements of the transaction has resulted in varying interpretations of the same basic principle.

Finally, although a variety of literature exists on the roles of these cases in elucidating the standards of review for mergers, this Note will seek to consolidate the new standards set out by courts in recent years, and highlight the areas where clarity is still required. The Note will also propose a solution for addressing the potential conflict posed by the differing standards of review, and address any gaps in the law. The Note will serve as a useful outline of the information available to the board of directors of a corporation for assessing the scrutiny it might face if its decisions during a merger (or a similar transaction) are under review.

Accordingly, Part I provides an overview of the existing standards of review for mergers, and their underlying principles; Part II discusses the conflicting case law, and highlights areas where there is a lack of clarity; Part III proposes a solution and calls for a consolidation of the standards of review for mergers involving a conflict of interest.

I. MERGERS

Companies merge for a variety of reasons: when they expect increased profits, anticipate a better competitive position, or simply wish to diversify the products and services they offer. Regardless, the manner in which these merger transactions are negotiated and ultimately structured has a huge impact on any judicial review that the transaction might face. As this Note shows, the different transactions are analyzed under differing levels of scrutiny, depending on the level of perceived conflict between the interests of the shareholders and those of the board of directors.

A. FORMS OF MERGER TRANSACTIONS

Although mergers can be structured in a variety of ways, the two most relevant to this discussion are mergers accomplished by combining

two companies with diversified shareholders, and those configured as freeze-out transactions.[1]

1. The A-B Merger: Combination of Two Companies with Diversified Shareholders

This involves a negotiated merger between two companies A and B whose shareholders are dispersed. The transaction can be accomplished in two ways.

a. Cash-based Transaction

Company B's shareholders are bought out and only A's shareholders hold the resulting company AB's stock. B's shareholders are no longer invested in company B or AB.

b. Stock-based Transaction

Company A's stock is given to B's shareholders. Here, both A's and B's shareholders remain shareholders in the resulting company AB.

2. The A-C Merger: Freeze-out Transactions

This involves a merger transaction between company A and another company C, which is controlled by A. The transaction can be accomplished by buying out the minority shareholders of company C. As a result, company A owns 100% of company C's stock, and C's shareholders are no longer invested in company C.[2] Freeze-outs can be

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1. Freeze-out transactions (also known as squeeze-out transactions or minority buyouts) involve one company's merger with another company that the first one controls. "Control" in this context has been defined as the ownership of more than 50% of the company's stock or "domination by a minority shareholder through actual control of corporate conduct." Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 70 (Del. 1989); *see also* Kahn v. Lynch Commc'n Sys., 638 A.2d 1110 (Del. 1994) (finding that a shareholder exercised control over the corporate decisions despite its minority shareholder status).

2. A freeze-out transaction can be carried out as a one-step or two-step merger. A one-step merger would simply require the controlling company to buy out the minority shareholders. In a two-step merger, the controlling company makes a tender offer to

structured in myriad ways but the two types of transactions that are important to this discussion are freeze-outs conducted as typical negotiated mergers, and freeze-outs conducted via tender offers.

a. Negotiated Merger

Freeze-out transactions structured as typical negotiated mergers have the controlling party on both sides of the deal, involve a special committee with veto power, and are (by default) reviewed under the entire fairness standard.[3]

b. Tender Offer

In a tender offer freeze-out, company A makes a tender offer for a majority of company C's shares, and then follows it with a short form merger.[4] Such freeze-outs have a controlling party negotiating with minority shareholders, involve a special committee without veto power, and are afforded more deference under the business judgment standard.[5]

B. FOUNDATIONS OF THE STANDARDS OF REVIEW: STATUTORY REQUIREMENTS AND FIDUCIARY DUTIES

Standards of review exist to analyze the decisions of a board of directors, but they do not dictate a particular line of conduct that a board must follow in order to get deference from the courts.[6] Standards of review simply "describ[e] what a plaintiff must plead or prove to overcome a defendant's motion and ultimately prevail in the case."[7] However, the standards of review are closely connected to the fiduciary duties that a board of directors must satisfy.

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acquire at least 90% of the target company's shares, and then instigates a short form merger. *See* DEL. CODE. ANN. tit. 8, § 253 (West 2014).

3. Guhan Subramanian, *Fixing Freezeouts*, 115 YALE L.J. 2, 22 (2005).

4. *See* DEL. CODE. ANN. tit. 8, § 253 (West 2014).

5. Subramanian, *supra* note 3.

6. J. Travis Laster, *Revlon Is a Standard of Review: Why It's True and What It Means*, 19 FORDHAM J. CORP. & FIN. L. 5, 26 (2013).

7. *Id.*; *see also* Melvin A. Eisenberg, *The Divergence of Standards of Conduct and Standards of Review in Corporate Law*, 62 FORDHAM L. REV. 437 (1993).

1. Statutory Requirements

Section 141 of the Delaware General Corporation Law sets forth the powers and duties of the board of directors of a corporation, bestowing upon the board the authority to make business decisions for the corporation.[8] Section 251 of the Delaware General Corporation Law sets forth the conditions for a merger. It provides that a merger transaction requires the approval of the board of directors of the company as well as approval by a majority of shareholders.[9]

Predictably, board approval is required to ensure that the transaction is viable for the corporation, while the shareholder vote is required to alleviate any concerns regarding potential conflicts of interest. These conflicts of interest can arise regardless of the manner in which the merger transaction is structured. For instance, in the merger of companies A and B as described above, there is the possibility that the board of directors of the target company B may resist an otherwise attractive offer of cash for the company's stock because they have a personal interest in maintaining their employment after the completion of the merger.

Contrastingly, in the merger of companies A and C above, company C's board of directors may accept an inadequate offer to protect their employment once company C is absorbed into company A.[10] In either scenario, there lies the potential that the board of directors may make a decision about the merger that may not be in the best interests of the corporation and its shareholders.

2. Fiduciary Duties

The board of directors owes a duty of care and a duty of loyalty to the corporation's shareholders. Whether the board's conduct has satisfied these duties determines the level of deference a board is likely to be accorded. In the first instance, the court looks at the board's conduct to determine whether its acts were negligent. As long as the

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8. DEL. CODE. ANN. tit. 8, § 141 (West 2014).

9. DEL. CODE. ANN. tit. 8, § 251 (West 2014). *But see* DEL. CODE. ANN. tit. 8, § 253 (West 2014) (stating that merger can be accomplished without a shareholder vote where the controlling corporation owns at least 90% of the shares of the target corporation).

10. *See infra* p. 151.

board of directors can show that its conduct was not grossly negligent or in bad faith, it can satisfy the duty of care and is given deference under the business judgment standard of review.[11] Under this standard, the court declines to "substitute its judgment for that of the board if the latter's decision can be 'attributed to any rational business purpose.'"[12]

Alternatively, the presence of a "qualified decision maker" can satisfy the court's inquiry as well; if "an independent, disinterested, and sufficiently informed decision maker" exists, the court would ordinarily defer to its judgment under the business judgment rule.[13] For a plaintiff shareholder to rebut the presumption of care inherent in this standard of review, it must prove that the qualified decision maker either "receiv[ed] a personal benefit from the transaction not received by the shareholders generally" or that the director "is a dual fiduciary and owes a competing duty of loyalty to an entity . . . on the other side of the transaction."[14]

The qualified decision maker is most likely to be an "independent, disinterested, and sufficiently informed" board of directors, but the court will also defer to a qualified decision maker in other instances. For example, stockholders collectively can act as qualified decision makers, as can a board committee.[15]

Similarly, the duty of loyalty imposes on the board a duty:

> not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage . . . . The rule that requires an undivided and unselfish loyalty to the corporation demands that there shall be no conflict between duty and self-interest.[16]

Consequently, when there is a direct conflict of interest—which violates the board of directors' duty of loyalty—the entire fairness standard is applied. Where the board of directors of a corporation fails to act in the interests of the shareholders, the court must assess the transaction to see

11. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984).

12. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 949 (Del. 1985) (quoting Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971)).

13. J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny*, 40 WM. MITCHELL L. REV. 1443, 1443 (2013).

14. Cede & Co. v. Technicolor, Inc., 884 A.2d 26 (Del. 2005); Laster, *supra* note 13, at 1452.

15. Laster, *supra* note 13, at 1456.

16. Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939).

if it is objectively fair to the shareholders. The defendant-directors then have the burden of showing that the entire transaction was fair to the shareholders of the corporation, and that they acted in good faith.[17]

The Delaware courts, however, soon realized that there were a host of transactions which did not fall into either of the above categories. The landmark decisions of the Delaware court in *Unocal* and *Revlon* gave rise to a third standard of review: the enhanced scrutiny test. Here, the measure is "range of reasonableness," i.e., whether the board's decisions were reasonable in the context of the transaction.[18] As described by the court in *Unocal*, the enhanced scrutiny test requires the directors to show "(i) 'reasonable grounds for believing that a danger to corporate policy and effectiveness existed' and (ii) a response to the danger that was 'reasonable in relation to the threat posed.'"[19] The *Revlon* case further developed this standard, and held that in the event where the sale of a corporation is imminent, the duties of the board of directors shift "from the preservation of [the company] as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit."[20]

The driving principle behind the Delaware court's decisions in *Unocal* and *Revlon* is that there are "potential conflicts of interest present in a negotiated acquisition."[21] Many factors can influence the board of directors to act in a manner that undercuts the best interests of the corporation and its shareholders without resorting to acts that would constitute self-dealing.[22] The enhanced scrutiny standard was developed to deal with these subtleties, which exist not only when the board is in complete control of the corporation but also during the period of the corporation's final sale.[23]

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17. *See Unocal Corp.*, 493 A.2d at 952.
18. *See id.*
19. Laster, *supra* note 6, at 9 (quoting *Unocal Corp.*, 493 A.2d at 955).
20. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986).
21. Laster, *supra* note 6, at 7.
22. *Id.* at 18.
23. *See id.* at 16.

II. DIFFERING STANDARDS OF REVIEW FOR CONFLICTED MERGER TRANSACTIONS

This part of the Note traces two parallel (and occasionally overlapping) paths in the case law defining the standards of review for mergers: one, a result of *Revlon*'s application of *Unocal*, and the other, a series of developments in the doctrine of freeze-out mergers.

A. THE A-B MERGER: ISSUES WITH APPLICATION OF THE STANDARD SET FORTH IN *UNOCAL*/*UNITRIN*/*REVLON*

In *Unocal*, the board of directors was faced with a shareholder who executed a two-tier tender offer for shares of the corporation. The board responded to the inadequate offer with a plan to execute a self-tender for the company's shares while excluding the plaintiff shareholder. The *Unocal* court famously held that:

> [b]ecause of the omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders, there is an enhanced duty which calls for judicial examination at the threshold before the protections of the business judgment rule may be conferred.[24]

This heightened examination of the board's decisions gave rise to the enhanced scrutiny standard of review. However, it is important to note that even within *Unocal*, there was a de-escalation of the standard of review after the court's initial inquiry. The enhanced scrutiny standard was effectively part of a two-step inquiry into the board's decision-making.[25] Once the court determined that the board's actions were "reasonable in relation to the threat posed," and thus, passed the enhanced scrutiny test, the court deferred to the board under the business judgment rule.[26]

In *Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361 (Del. 1995), the Delaware Supreme Court clarified the application of the enhanced scrutiny standard laid out in *Unocal*. In *Unitrin*, the board of directors of the corporation was faced with an offer by American

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24. *Unocal Corp.*, 493 A.2d at 954.

25. William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1310 (2000).

26. *Unocal Corp.*, 493 A.2d at 949.

General Corporation. The board rejected the offer, on the grounds that it was inadequate.[27] American General, however, announced its plan for a hostile takeover, and the board of Unitrin adopted a buyback plan as part of its defensive measures against the threat.[28] The court held that in instances where the corporation faces the threat of a hostile takeover, courts must examine first, whether the defensive measures adopted by the board of directors are "draconian, by either being preclusive or coercive and; second, . . . whether [the measures are] within a range of reasonable responses to the threat."[29]

Here, the court applied *Unocal* and examined the board's actions under the two-pronged test of reasonableness and proportionality.[30] The court found that the board of directors met the reasonableness prong based not only on the board's belief that American General's offer was inadequate but also because of "the presence of a majority of outside independent directors."[31] The court also held that the board's response in adopting a repurchase program was proportional to the threat it faced without "depriv[ing] the public stockholders of the 'power to influence corporate direction through the ballot.'"[32]

The court in *Revlon* further extended the enhanced scrutiny standard to the sale of a corporation. In *Revlon*, the board of directors faced a hostile takeover by Pantry Pride.[33] In response, the board first adopted several defensive measures, which the court found to be reasonable in response to the takeover threat.[34] However, once the board realized that the sale of the corporation was inevitable, it began selectively dealing with another buyer, Forstmann, to arrange a leveraged buyout.[35] Balancing deference to the business judgment of the directors with "the omnipresent specter that a board may be acting primarily in its own interests," the court in *Revlon* found that the board

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27. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1369 (Del. 1995).
28. *Id.* at 1370.
29. *Id.* at 1367.
30. *See id.* at 1373.
31. *Id.* at 1375.
32. *Id.* at 1383.
33. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).
34. *Id.*
35. *Id.*

had failed to meet its responsibilities under *Unocal*.[36] Once the sale of the corporation was imminent, the court held that "[t]he directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."[37]

The case law since then has interpreted *Revlon* as requiring the board of directors to satisfy a specific set of duties when the sale of a company is inevitable. In *Paramount Communications, Inc. v. Time Incorporated*, Paramount made a tender offer for Time's shares shortly before Time finalized a stock-for-stock merger with Warner.[38] Paramount sought to enjoin the Time-Warner merger after Time rejected its offer as inadequate, but the court declined.[39] Paramount claimed that the Time-Warner merger agreement required the board to obey its *Revlon* duties, and thus "to treat all other interested acquirers on an equal basis" in order to maximize the value of the company for the shareholders.[40] The court held, instead, that the board had no specific responsibility to transact with the company offering the highest immediate value for the shareholders outside the context of *Revlon*.[41] The court further described two scenarios that would trigger *Revlon* duties:

> The first, and clearer one, is when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company. . . . However, *Revlon* duties may also be triggered where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the breakup of the company.[42]

According to this analysis, unless the sale or breakup of a corporation is imminent or inevitable, *Revlon* duties are not triggered. Keeping in line with this reading of *Revlon*, the court here held that there was no "abandonment of the corporation's continued existence,"

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36. *Id.*; *see also* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985); Aronson v. Lewis, 473 A.2d 805 (Del. 1984).
37. *Revlon, Inc.*, 506 A.2d at 182 (Del. 1986).
38. *See* Paramount Commc'ns, Inc., v. Time, Inc., 571 A.2d 1140 (Del. 1989).
39. *Id.*
40. *Id.* at 1149.
41. *Id.* at 1151.
42. *Id.* at 1150.

and thus, no further *Revlon* analysis was needed.[43] The court also found that the board reasonably perceived a threat, and adopted a reasonable defensive measure.[44] Accordingly, the board's decisions passed the enhanced scrutiny review under *Unocal*, and thus, the board's actions were given business judgment deference.[45]

In another case involving Paramount, the court faced a similar question. Paramount was in talks with Viacom regarding the possibility of a merger.[46] Eventually, the Paramount board approved the transaction, the terms of which included a number of defensive measures.[47] During this time, Paramount was also approached by QVC but the board eventually rejected QVC's bid because the directors did not deem it to be in the "best interests of the stockholders."[48] When the Paramount-Viacom transaction was challenged, the court found that the Paramount board had failed to meet its duties under *Revlon*.[49]

Unlike the court in *Time*, which relied primarily on the absence of an inevitable sale of the company, the *QVC* court gave great significance to the sale of control of the corporation in assessing whether the *Revlon* duties were triggered.[50] The *QVC* court reasoned that "[w]hen a majority of a corporation's voting shares are acquired by a single person or entity . . . there is a significant diminution in the voting power of those who thereby become minority stockholders."[51] This change in control of a corporation triggers the application of *Revlon* duties because the board is once again under an obligation to maximize shareholder value.[52] The *QVC* court further clarified that an imminent sale of the company was not the only scenario that would result in the application of *Revlon* duties.[53] Applying this standard, the court held that the Paramount board had failed to meet the enhanced scrutiny review.

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43. *Id.* at 1151.
44. *Id.* at 1152.
45. *Id.*
46. *See* Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34 (Del. 1993).
47. *Id.*
48. *Id.* at 41.
49. *Id.*
50. *Id.* at 42.
51. *Id.*
52. *Id.*
53. *Id.* at 46-47.

Taken together, the *Paramount* cases seem to imply differing standards of review based on how the transaction was conducted. If the transaction results in a controlling party, *Revlon* applies.[54] However, if there is no controlling party, *Revlon* still applies in a cash-based transaction but not in the case of a stock-for-stock merger.[55]

What is problematic, however, is that the *Paramount* cases presume that there exists a set of specific *Revlon* duties in the first place:

> One view of the holding in *Revlon* was that it was premised on a duty (the duty to auction the company when it was for sale, or, less woodenly, the duty to get the best price, or the duty not to discriminate between bidders) that *was different in some way from ordinary director duties* . . . . [O]nce a "sale" of the corporation was in contemplation, "Revlon duties" would be thought to limit the range of good faith business judgment that the board might make.[56]

The Delaware courts quickly squashed this interpretation, holding that the *Revlon* case "did not create a new or special regime."[57] As Vice Chancellor Laster stated, "*Revlon* merely identified one special circumstance in which the board of directors had narrowed the investment horizon for maximizing stockholder value to a specific point in time."[58] Thus, *Revlon* should not be read as creating new duties for the board of directors which did not exist previously.[59] Rather, *Revlon*, like several cases that followed it, only sought to outline what compliance with the pre-existing duties would look like in the context of a sale.[60]

B. THE A-C MERGER: FREEZE-OUT TRANSACTIONS

The emergence of freeze-out transactions further complicated the application of the enhanced scrutiny standard of review. Freeze-out

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54. *See* J. Travis Laster, *Exposing a False Dichotomy: The Implications of the No-Talk Cases for the Time/Revlon Double Standard*, 3 DEL. L. REV. 179, 187 (2000); *see also* J. Travis Laster, *Revlon is a Standard of Review*, 19 FORDHAM J. CORP. & FIN. L. 5, 37 (2013).

55. J. Travis Laster, *Exposing a False Dichotomy: The Implications of the No-Talk Cases for the Time/Revlon Double Standard*, 3 DEL. L. REV. 179, 187 (2000).

56. Equity-Linked Inv'rs, L.P. v. Adams, 705 A.2d 1040, 1045 (Del. Ch. 1997).

57. Laster, *supra* note 55, at 201.

58. *Id.* at 205.

59. *Id.* at 204.

60. *See generally* Laster, *supra* note 55.

transactions have been subject to differing standards of review based on the procedural and substantive context of the merger. Freeze-outs structured as negotiated mergers have typically been reviewed under the entire fairness standard, while those structured as tender offers have been afforded the more lenient business judgment review.[61]

1. Negotiated Merger

The landmark case *Weinberger v. UOP* addressed the standard of review applicable to freeze-outs conducted as typical merger transactions. The facts of this case are as follows: Signal had a cash surplus and invested some of its cash by acquiring a majority of UOP's stock via a tender offer.[62] Then, failing to find any other attractive investment opportunities for the remaining cash surplus, Signal began assessing the possibility of acquiring the remaining outstanding shares of UOP.[63] In the negotiations that followed, two UOP directors who were also employees of Signal prepared a "feasibility report" for Signal but failed to disclose this material information to the other, outside UOP directors.[64] The report mentioned that Signal could profitably acquire the outstanding UOP shares "at any price up to $24 each," a fact that was not disclosed to the independent directors of UOP.[65] In fact, the price actually proposed to UOP's board and its minority shareholders was $21 per share.[66] The court in *Weinberger* drew upon the duty of loyalty principles, and opined that "[w]hen directors of a Delaware corporation are on both sides of a transaction, they are required to demonstrate their utmost good faith and the most scrupulous inherent fairness of the bargain."[67] The court held that the transaction would be reviewed under the entire fairness test, which (among other showings) must include a showing of fair price and fair dealing.[68]

In the cases that followed *Weinberger*, there was a lack of clarity over the standard of review applicable in cases where a cash-out merger

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61. *See supra* Section I.A.2.
62. Weinberger v. UOP, Inc., 457 A.2d 701, 703 (Del. 1983).
63. *Id.* at 705.
64. *Id.* at 705, 707.
65. *Id.*
66. *Id.* at 707.
67. *Id.* at 710.
68. *See id.* at 710-11.

had been approved by an independent special committee.[69] Delaware courts were divergent in their application of *Weinberger*: some cases held that the presence of an independent committee only operated as a burden-shifting mechanism, while others contended that the committee's approval de-escalated the standard of review to the business judgment rule.[70] *Kahn v. Lynch Communications* clarified this split, and established entire fairness as the applicable standard of review in freeze-out mergers.[71] Based in part on the court's holding in *Weinberger*, the court in *Lynch* held that:

> [t]he initial burden of establishing entire fairness rests upon the party who stands on both sides of the transaction. However, an approval of the transaction by an independent committee of directors or an informed majority of minority shareholders shifts the burden of proof on the issue of fairness from the controlling or dominating shareholder to the challenging shareholder-plaintiff.[72]

In order to trigger the burden-shifting mechanism, however, the special committee must also be "truly independent, fully informed, and [have] the freedom to negotiate at arm's length."[73] As is apparent in the court's analysis, the court declined to apply business judgment review, even if the transaction had been approved by either an independent committee or a majority of the minority shareholders. "[The] Court recognized that it would be inconsistent with its holding in *Weinberger* to apply the business judgment rule in the context of an interested merger transaction, which, by its very nature, did not require a business purpose."[74]

The court in *Kahn v. M&F Worldwide*[75] outlined the procedural protections that must be in place in order to de-escalate the standard of review from entire fairness to the business judgment rule, as applicable to freeze-out mergers. In *M&F Worldwide*, a controlling shareholder sought to buy out the outstanding shares of MFW, subject to approval

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69. *See* Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490 (Del. Ch. 1990); *see also* Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1156 (Del. Ch. 1991).

70. *See* Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1115 (Del. 1994).

71. *See id.*

72. *Id.* at 1117 (citation omitted).

73. *Id.* at 1120-21; *see also* Rosenblatt v. Getty Oil Co., 493 A.2d 929, 937 (Del. 1985).

74. *See Lynch*, 638 A.2d at 1116.

75. Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014).

by MFW's board of directors, an independent special committee, and a majority of the non-controlling shareholders.[76] While the plaintiffs argued that even the combination of these procedural safeguards could prove to be insufficient in guarding the interests of the minority shareholders, the court held that the business judgment standard would apply to the transaction if:

> (i) the controller conditions the procession of the transaction on the approval of both a Special Committee and a majority of the minority stockholders; (ii) the Special Committee is independent; (iii) the Special Committee is empowered to freely select its own advisors and to say no definitively; (iv) the Special Committee meets its duty of care in negotiating a fair price; (v) the vote of the minority is informed; and (vi) there is no coercion of the minority.[77]

The court here ensured that a variety of procedural protections had to be in place in order to neutralize the power of the controlling party to influence the transaction.

2. Tender Offer

Tender offer freeze-outs have typically been accorded business judgment review because the controlling party is only on one side of the transaction, eliminating the threat of self-dealing that is present in the typical freeze-out mergers.[78] One instance of this is the court's holding in *In re Siliconix*.[79] In that case, the majority shareholder sought to acquire all of the remainder of the company's stock via a cash tender offer, which was then changed to a proposal for a stock-for-stock transaction after the special committee rejected the offered share price.[80] The controlling shareholder proceeded with the transaction without the special committee's approval.[81] The transaction was nonetheless subject

76. *Id.* at 640.
77. *Id.* at 645.
78. Subramanian, *supra* note 3, at 18*; see also* Solomon v. Pathe Commc'n Corp., 672 A.2d 35 (Del. 1996).
79. *See In re* Siliconix Inc. S'holder Litig., No. Civ. A. 18700, 2001 WL 716787 (Del. Ch. 2001).
80. *Id.* at *2-4.
81. *Id.* at *4.

to approval by a majority of the minority shareholders.[82] The court held that the controlling shareholder had "no duty to offer any particular price, or a 'fair' price, to the minority shareholders of Siliconix unless actual coercion or disclosure violations [were] shown," and consequently declined to apply the entire fairness standard of review.[83] This holding derives partly from the law established in *Solomon v. Pathe Communications* where the court held that without evidence of coercion or inadequate disclosure, the tender offer is deemed voluntary, and thus there is no duty to offer a certain price.[84]

However, the courts soon recognized the inherent imbalance in negotiations between controlling parties and minority shareholders in tender offer freeze-outs. In *In re Pure Resources, Inc.*, the court sought to reconcile—at least in part—"the divergent policy choices made in *Lynch* and *Solomon*" by nesting the principles of *Solomon* within the analysis under *Lynch*.[85] The court held that the entire fairness standard of review would apply to such transactions if the tender offer is coercive.[86] The offer would be deemed non-coercive only if it was "subject to a non-waivable majority of the minority tender condition," "the controlling stockholder [promised] to consummate a prompt § 253 merger at the same price if it [obtained] more than 90% of the shares," and "the controlling stockholder . . . made no retributive threats."[87] However, these factors are all in control of the controlling shareholder, and minority shareholders have no way of challenging them.

As noted earlier, the *Paramount* cases apply the enhanced scrutiny standard of review in two instances: one, where the transaction is cash-based, and two, where the transaction is stock-based but also results in the presence of a controlling shareholder after the transaction.[88] This is primarily because the voting power of the resulting minority shareholders significantly weakens.[89] However, as Vice Chancellor Laster has argued, the underlying principle of this standard is the

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82. *Id.* at *4.
83. *Id.* at *6.
84. Solomon v. Pathe Commc'n Corp., 672 A.2d 35, 39 (Del. 1996).
85. *In re* Pure Res., Inc., S'holder Litig., 808 A.2d 421, 439 (Del. Ch. 2002); *see also Solomon*, 672 A.2d 35.
86. *In re Pure Res., Inc., S'holder Litig.*, 808 A.2d at 445-46.
87. *Id.* at 445; *see also* DEL. CODE. ANN. tit. 8, § 253 (West 2014).
88. Laster, *supra* note 6, at 6-7.
89. *See* Paramount Commc'n, Inc. v. QVC Network, Inc., 637 A.2d 34, 42 (Del. 1993).

presence of potential conflicts of interest, which exist in all negotiated transactions, whether they are conducted in cash or stock,[90] and whether they are in the form of a freeze-out merger or a freeze-out tender offer.

Understandably, if the transaction uniquely benefits a controlling party to the exclusion of other shareholders, the appropriate standard of review is entire fairness, even if a qualified decision maker exists.[91] In that case, "neither a special committee nor a majority-of-the-minority vote . . . [nor] [a]n independent stockholder vote" alone is enough to deescalate the standard of review from entire fairness.[92] The special dynamics that exist within a corporation in the presence of a controlling party essentially neutralize the power of committees and independent stockholder votes (and, in the case of tender offers, the stockholders' tenders of their shares) because the controlling party exerts influence "at both the board and stockholder levels."[93] However, as seen in *Lynch*, the presence of a special committee or a majority-of-the-minority vote can shift the burden on to the plaintiff shareholder, requiring it to establish that the transaction was unfair. This burden-shifting mechanism, however, is not at play in the case of freeze-outs conducted as tender offers.

What remains unclear is whether the standards of review for all freeze-outs (whether conducted through tender offers or as typical mergers) should be streamlined into one. Although *M&F Worldwide* did unify the standard of review for both types of freeze-outs by de-escalating the standard of review for typical freeze-out mergers to business judgment review instead of entire fairness, the unification of the standards only occurs if the procedural protections outlined in *M&F Worldwide* are applied by the board and deemed acceptable by the court.[94] As seen above, for freeze-out transactions, the procedural protections can be challenged and may lead to a burden-shifting analysis.[95] If the court's inquiry is satisfied, the standard of review for the board's conduct again shifts dramatically from one extreme to

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90. *See id.* at 33, 35.
91. Laster, *supra* note 13, at 1461.
92. *Id.*
93. *Id.* at 1460.
94. *See* Kahn v. M&F Worldwide Corp., 88 A.3d 635 (Del. 2014).
95. *See supra* Section II.B.1; *see also* Kahn v. Lynch Commc'n Sys., Inc., 639 A.2d 1110, 1115 (Del. 1994).

another.[96] It is important to note, however, that these concerns do not arise in freeze-out tender offers: there is nothing for the shareholder to challenge there, as long as the board refrains from making threats.[97]

Additionally, the standards of review for freeze-out mergers remain entirely removed from the enhanced scrutiny standard set out in *Unocal* and *Revlon*, even though the underlying principle behind the latter cases—addressing conflicts of interest that endanger stockholder interests—seems to be present in freeze-out transactions as well. Specifically, in a typical freeze-out merger, the controlling party is on both sides of the transaction, and in a tender offer freeze-out, the controlling party often has disproportionate bargaining power compared to the minority shareholders with whom it negotiates. Both of these circumstances endanger the shareholders' interests. Furthermore, as has been noted in current literature, the business judgment review afforded to all tender offer freeze-outs may not be sufficient to look after the interests of the minority shareholders, while an "entire fairness review for all freeze-outs may deter some value creating transactions."[98]

III. PROPOSED SOLUTION: UNIFIED STANDARD OF REVIEW FOR CONFLICTED TRANSACTIONS

A. APPLYING THE *UNOCAL*/*REVLON* ENHANCED SCRUTINY STANDARD TO FREEZE-OUT MERGERS

There is an intermediate standard of review that is available to address the imperfect extremes of judicial review under the business judgment standard and the entire fairness standard. The enhanced scrutiny review, applied above to A-B merger transactions,[99] should be made available to A-C merger transactions as well.

As discussed earlier, the potential for conflicts of interest lies in A-B and A-C transactions because the board may feel compelled to act in ways that betray its allegiance to the corporation and the corporation's shareholders.[100] Although A-B and A-C mergers are structured

96. *See M&F Worldwide*, 88 A.3d at 635.

97. *See In re* Pure Res., Inc., S'holder Litig., 808 A.2d 421, 439 (Del. Ch. 2002); *see also In re* Siliconix Inc. S'holder Litig., No. Civ. A. 18700, 2001 WL 716787 (Del. Ch. 2001).

98. *See* Subramanian, *supra* note 3, at 22.

99. *See supra* Section II.A.

100. *See supra* Section II.B.1.

differently, this conflict is at the core of both types of transactions.[101] In both instances, the intermediate level of scrutiny serves to address this issue: that there may be instances where the board's conduct is not grossly negligent but where the "omnipresent specter" is nonetheless at play.[102] The intermediate scrutiny standard will also guard against instances where the qualified decision maker, if one exists, is unable to act as intended in the presence of such conflicts of interest.

Thus, enhanced scrutiny should be the appropriate standard of review for conflicted transactions, even those that employ procedural or substantive protections to safeguard the interests of minority shareholders. Adopting the enhanced scrutiny standard for mergers involving conflicts of interest would extend the application of the case law established by *Unocal* and its progeny beyond the traditional negotiated transactions, and apply it to the many forms of freeze-out transactions. Applying the enhanced scrutiny standard would also eliminate a two-step review, and prevent the de-escalation from one extreme level of review to another.

B. INTERPRETING *M&F WORLDWIDE* AND *SILICONIX* AS SATISFACTION OF THE BOARD'S DUTIES UNDER *REVLON*

Before enhanced scrutiny can be effectively applied to such mergers, however, there needs to be a final clarification of the duties of a board under *Unocal* and *Revlon*. As Vice Chancellor Laster has discussed (and contrary to popular interpretation), there does not seem to be a set of specific *Revlon* duties that a board must undertake when the sale of a corporation is imminent.[103] The enhanced scrutiny standard cannot be effectively applied to freeze-out transactions until the board's duties have been clarified, especially because freeze-out transactions are analogous to final-sale transactions because they result in the buyout of minority shareholders.[104] Finally, as Vice Chancellor Laster contends, "the perceived double standard for director conduct in change-of-control

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101. *See supra* Section II.B.1.
102. *See supra* text accompanying note 24.
103. J. Travis Laster, *Exposing a False Dichotomy*, 3 DEL. L. REV. 179, 219 (2000).
104. *See id.*

transactions and stock-for-stock mergers is a false dichotomy . . . there are no special and distinct *Revlon* duties."[105]

The aim of the *Revlon* duties is to ensure that the board of directors treats all bidders equally in the event of the corporation's sale.[106] These so-called *Revlon* duties then apply only in that context (or in an analogous one).[107] This Note proposes that in order to grant enhanced scrutiny review to mergers involving conflicts of interest, cases such as *M&F Worldwide* and *Siliconix* should be viewed as describing the ways in which a board of directors can satisfy its fiduciary duties under each case's particular circumstances. This would consolidate the divergent case law and bring clarity by enforcing a uniform standard of review. *M&F Worldwide* and *In re Pure Resources* should be viewed as satisfying the court's analysis under enhanced scrutiny review for freeze-out transactions conducted as typical mergers and via tender offers, respectively. Under this interpretation, the enhanced scrutiny standard would still maintain the flexibility to prescribe how a board may satisfy its duties in a particular instance. Thus, if A-C mergers are reviewed under the enhanced scrutiny standard (traditionally applied to A-B mergers), then *M&F Worldwide* and its antecedents can be nested under the *Unocal*/*Revlon* analysis.

In proposing a unified standard of review for all mergers where there is a conflict of interest, this Note does not contend that the business judgment review and the entire fairness standard are obsolete. Rather, those two standards of review are at opposite ends of the spectrum, and should be applied where there is either an obvious violation (or lack thereof) of the board's fiduciary duties. In all other transactions involving conflicts of interest, the courts should apply enhanced scrutiny as a one-step standard of review.

CONCLUSION

Delaware doctrine on the standards of review for mergers has its roots in the landmark cases of *Unocal* and *Revlon*. However, the analysis employed in these cornerstone cases needs to be effectively

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105. *Id.*

106. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

107. *See generally Revlon, Inc*, 506 A.2d 173; Paramount Commc'n, Inc. v. QVC Network, Inc., 637 A.2d 34, 42 (Del. 1993).

applied to the complex and varied structures of merger transactions in order to ensure the balance between the preservation of shareholder interests and the maintenance of a board's autonomy to make business decisions. In the extreme instance where the board of directors is embroiled in a glaring conflict of interest, the courts should certainly require the board to demonstrate that the entire transaction was fair to the shareholders. At the opposite end of the spectrum, where it is apparent that the board made a reasonable business decision, the courts should continue to accord the directors the protections of the business judgment rule.

For transactions that hold the possibility of a conflict of interest and that threaten to disrupt the balance between shareholder interests and board autonomy, there exists a fitting intermediate standard of scrutiny as set forth in *Revlon* and *Unocal*. The enhanced scrutiny standard is based on the principles of balancing the sometimes-conflicting interests of those who make the decisions and those who are most affected by them. Despite the several forms of structuring merger transactions, this tension between the conflicting interests almost always exists.

It is only appropriate then, to apply a uniform standard of review to these transactions instead of altering the standard to accommodate the structural complexities of the merger. While calling for this uniform standard's application to mergers involving a conflict of interest, this Note does not suggest that the Delaware courts' holdings over the last four decades should be disregarded entirely. Rather, the Note argues that the courts' holdings over the years should be merged into the enhanced scrutiny standard itself, instead of the vacillation between entire fairness and business judgment review. The enhanced scrutiny review, alone, efficiently looks after conflicting interests that lie at the heart of many merger transactions.