Delaware case law balancing the conflicting interests of directors and shareholders in corporate takeovers has been "eroded," tilting the merger and buyout playing field in favor of management, the state business court’s chief judge said at a legal conference Monday. Chancellor William Chandler was the featured speaker at a corporate law conference at the Widener University School of Law in Wilmington that focused on the sea changes in Delaware case law that have reshaped merger and acquisition litigation.

**Keeping the Drawbridge Up**

The Chancery Court judge said recent state Supreme Court decisions on takeover defenses wrongly let directors pull up the company's drawbridge until a hostile suitor goes away — even when the shareholders want to take the buyer’s offer.

Widener marshaled a faculty of prominent judges, lawyers, bankers, institutional investors and law professors to explore ways to rebalance the power of management and shareholders in contested mergers and rein in the shareholder litigation that has mushroomed during the resurgence of merger and buyout deals.

Delaware has become the favorite state of incorporation for most of the nation’s large corporations because of its renowned business court and its balanced approach to the inherent tension between shareholders and management over who runs the company.

**A Lethal Combination**

Chandler presided over a recent high-profile case involving a takeover battle between Airgas Inc. and Air Products & Chemicals. He said the Delaware Supreme Court's decisions forced him to allow Airgas’ directors to continue to use two potent anti-takeover defenses against suitor Air Products, even though the only threat to justify the use of those weapons was Air Products’ failure to meet the board's price. Air Prods. & Chems. v. Airgas Inc. et al., No. 5249; In re Airgas Inc. S’holder Litig., No. 5256, 2011 WL 519735(Del. Ch. Feb. 15, 2011).

The Supreme Court rulings found those two measures were not improperly “preclusive” under Delaware law because they only delayed rather than defeated the takeover. But “the real-world combination [of those defenses] was absolutely lethal,” Chandler said.

Nevertheless, he said, state high court precedent gave him no choice but to allow Airgas to keep its takeover defenses in place simply because Air Products’ offer was too low. Air Products eventually gave up its yearlong pursuit of the company.
Unocal Erosion

During a merger and acquisition boom in the 1980s the Delaware Supreme Court, in the seminal Unocal decision, allowed directors to use takeover defenses to keep a hostile suitor from taking over the company but only so long as they were a reasonable response to the threat presented. Unocal Corp. v. Mesa Petrol. Co., 493 A.2d 946 (Del. 1985).

But the balance that Unocal established has been badly eroded by subsequent rulings that created too many exceptions to the high court’s standard and essentially let the directors just say no to every offer, according to Chandler.

Change-Of-Control Boards?

In numerous presentations and panel discussions, the corporate law bench, bar and law professors explored ways to untangle mergers and acquisitions and the lawsuits that challenge them.

Samuel Thompson Jr., a law professor at Penn State, advocated an amendment to Delaware corporate law that would allow the Chancery Court to appoint a special objective "change of control board" that would replace a company’s regular board of directors and have the final say whenever a merger, buyout or takeover was in the wind.

“This would breathe new life into such transactions,” especially in situations where the merger or buyout was initiated and driven by a controlling shareholder, by eliminating the possibility of self-dealing decisions and the resulting shareholder suits challenging the deal, Thompson said.

Long Odds

However, Thompson admitted that if Delaware enacted such a statute, it might "put some corporate lawyers out of work," and Chandler said the amendment would face long odds in the state Legislature.

James Woolery, a mergers specialist with JPMorgan Chase who advised Air Products in its thwarted bid for Airgas, predicted that the Delaware courts’ decisions in that case will put a damper on hostile acquisition efforts when the target has the defensive weapons Airgas used.

“What they (the Airgas decisions) said to the marketplace is that Delaware is not bidder friendly,” according to Woolery.

Not Good For Shareholders?

Famed Harvard law professor Lucian Bebchuk predicted that at least one of the takeover defenses that Airgas relied on, the “staggered board” provision, will fade away as shareholders refuse to approve them for the charters of new companies.
The provision ensures that only a fraction of the directors come up for re-election each year, making it impossible to replace a majority of the board in a single takeover move. Bebchuk said it has seldom been approved for new charters during the past 20 years.

That’s because “shareholder returns are significantly lower, comparatively speaking, for companies with staggered boards,” he explained. ”Staggered boards are just not good for shareholders.”

**Bad Deal or Bad Faith?**

Paul Regan, the acting head of the corporate law department at Widener, suggested a way to avoid some of the complex litigation over takeovers and buyouts: Give the Chancery Court the legal leeway to enjoin a flawed transaction without having to first determine that the directors who approved it had breached their fiduciary duty of loyalty to the shareholders.

“Shouldn’t he (the judge) be able to enjoin a bad transaction even if there’s no proof that the board approved it in bad faith?” he asked rhetorically.

The standard of proof to show that directors acted in bad faith is so much higher than what is required to demonstrate that the challenged transaction may be bad for the shareholders that the litigation becomes unnecessarily long and complicated, Regan said.

Mark Morton, a corporate litigation specialist with Potter Anderson & Corroon in Wilmington, agreed that more injunctions of transactions would provide more chances for other potential buyers to step in with a competing offer, especially in deals that have focused on one bidder.

He suggested a merger process option that would reimburse a prospective competing bidder for conducting a due diligence investigation and other preparation of a serious alternative offer.

**Whose Deal Is It?**

Research by Steven Davidoff, a University of Connecticut law professor and New York Times "Deal Professor" columnist, indicates that nearly half of the acquisitions and buyouts in Delaware were initiated by the company’s directors and officers.

He said shareholders generally got less in so-called management buyouts, which were popular in the years preceding the 2008 Wall Street meltdown and rebounded in 2010 and 2011.

New York Law School professor Faith Stevelman predicted that, instead of adopting new laws or legal procedures, Delaware is more likely to resolve the tangle of rules for mergers and acquisitions in an evolutionary fashion, as case law development gradually addresses the various problems that have plagued this new wave of transactions.

The “continuing interplay between lawyers and the Chancery Court” in one merger battle after another has fine-tuned Delaware case law into a kind of “transactional Talmud,” a dynamic rulebook of practical M&A do's and don'ts that corporate lawyers value, Stevelman said, ”and that’s Delaware’s strength.”