

THROUGH THE ANTITRUST LOOKING GLASS: A NEW VISION  
OF DELAWARE'S TAKEOVER-DEFENSE JURISPRUDENCE

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INTRODUCTION

SINCE the debut of the hostile tender offer in the late 1970s, no conflict in corporate law has been of greater consequence than the battle waged between hostile bidders and incumbent corporate directors. Delaware's jurisprudence governing this conflict has centered around a subtly complex concept—proportionality—as introduced in the seminal case of *Unocal Corp. v. Mesa Petroleum Co.*<sup>1</sup> Requiring directors to show that the defenses they adopted to fend off a hostile bidder were “reasonable in relation to the threat posed,”<sup>2</sup> *Unocal* added a heightened level of review to Delaware law's baseline requirement of good faith, adopted in *Cheff v. Mathes*,<sup>3</sup> and has been the dominant metric with which courts assess the propriety of a board's defensive tactics.<sup>4</sup>

In the 1995 case of *Unitrin, Inc. v. American General Corp.*, Delaware courts read a further step into the details of *Unocal*, requiring that before a court may engage in proportionality review, defendant directors

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<sup>1</sup> 493 A.2d 946, 955 (Del. 1985).

<sup>2</sup> *Id.*

<sup>3</sup> 199 A.2d 548, 555 (Del. 1964).

<sup>4</sup> See Mark J. Loewenstein, *Unocal* Revisited: No Tiger in the Tank, 27 Iowa J. Corp. L. 1, 1–5 (2001) (discussing the advent of *Unocal*, the important role it has played in Delaware corporate law, and the criticism it has garnered).

must demonstrate that their actions were not preclusive.<sup>5</sup> Failure to do so, along with failure to satisfy the already existing *Cheff* requirement of good faith, would result in an automatic ruling against a corporate board's takeover defense without room for argument under *Unocal*'s proportional balancing test.<sup>6</sup>

This framework—a review of good faith and preclusiveness followed by a balancing of threat and defense—seems simple enough. Yet the ambiguous nature of proportionality, good faith, and preclusiveness has allowed these concepts to escape straightforward definition, giving rise to a doctrine built on case-specific observations and providing little forward-looking guidance.<sup>7</sup> Perhaps most unfortunate was that *Unocal* proportionality review, initially billed as a comparison of the threat posed by a hostile bidder and the board's defensive response, never evolved into a true balancing of these two elements.<sup>8</sup> Unable to adopt a standardized set of factors to indicate where a given threat and defense fell on the spectrum of severity, Delaware courts struggled to establish a predictable method by which directors' actions could be weighed against the dangers threatening their shareholders.<sup>9</sup> The failure of *Unocal* proportionality review to develop into anything more than a fact-specific inquiry with little precedential value could easily be viewed as one of Delaware corporate law's greatest disappointments.<sup>10</sup>

In the face of widespread criticism from academic commentators and their frequent calls for doctrinal overhaul in the name of predictability and bright-line rules,<sup>11</sup> this Note argues that the ad hoc quality of *Unocal* proportionality review, along with inconsistencies in the application of

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<sup>5</sup> 651 A.2d 1361, 1387 (Del. 1995).

<sup>6</sup> *Id.*

<sup>7</sup> See Park McGinty, *The Twilight of Fiduciary Duties: On the Need for Shareholder Self-Help in an Age of Formalistic Proceduralism*, 46 *Emory L.J.* 163, 270 (1997) (noting that "Delaware courts have struggled unsuccessfully to find an appropriate proxy for assessing threat and proportionality" and discussing the varied, inconsistent criteria on which these courts have relied in performing *Unocal* review).

<sup>8</sup> See *infra* Section II.A.

<sup>9</sup> See *id.*

<sup>10</sup> See Stephen M. Bainbridge, *Unocal at 20: Director Primacy in Corporate Takeovers*, 31 *Del. J. Corp. L.* 769, 772 (2006) (observing that "[o]ver the last twenty years, academics and others have subjected *Unocal* to unrelenting criticism" and cataloguing a long list of negative academic commentary).

<sup>11</sup> See, e.g., *id.*; Bernard Black & Reinier Kraakman, *Delaware's Takeover Law: The Uncertain Search for Hidden Value*, 96 *Nw. U. L. Rev.* 521, 521 (2002); Julian Velasco, *The Enduring Illegitimacy of the Poison Pill*, 27 *J. Corp. L.* 381, 390–97 (2002).

Delaware's good-faith and preclusiveness requirements, is entirely appropriate in the context of takeover-defense jurisprudence. It reaches this conclusion by likening Delaware's takeover-defense doctrine to federal antitrust law's Rule of Reason, which polices illegal restraints on trade under the Sherman Act.<sup>12</sup> Using this comparison, this Note presents a novel paradigm for understanding Delaware's review of defensive measures, positing that the regime's so-called flaws are actually key components of an effective, antitrust-like mechanism for evaluating directors' implementation of takeover defenses.

To this end, Part I begins with a brief overview of Delaware's takeover-defense law followed by a chronological discussion of the doctrine's foundational cases. While providing a high-level overview of the law's development, the analysis will devote much of its energy to drawing out the inconsistencies in the application of the *Cheff-Unocal-Unitrin* framework, paying particular attention to the lack of comparative balancing employed during *Unocal* proportionality review and emphasizing the effects-based character, similar to the Rule of Reason, that this form of review has assumed.

Part II, relying on the observations of Part I, will sort the flaws in Delaware's takeover-defense jurisprudence into three discrete categories, laying the foundation for their resolution in Section III.B. In doing so, it will incorporate the most recent developments in Delaware corporate law, highlighting the effects-oriented quality of proportionality review, the lingering uncertainty surrounding *Unitrin*'s ban on preclusiveness, and the fluctuating contours of the *Cheff* good-faith requirement.

Finally, Part III will attempt to reconcile the flaws presented in Part II within a new framework paralleling federal antitrust law's Rule of Reason. To do so, it will provide a brief overview of antitrust law—a series of burden-shifting prerequisites and prohibitions that, if satisfied, lead to an effects-based assessment of whether a given restraint's net effects are pro- or anti-competitive. Part III then likens Delaware's analysis of takeover defenses to federal antitrust review, analogizing *Cheff*'s good-faith requirement to the preliminary evidentiary burden shouldered by antitrust defendants and *Unitrin*'s preclusiveness ban to antitrust law's censure of certain restraints as per se illegal. Most importantly, Part III argues that *Unocal* proportionality review is best viewed not as a balancing of threat and defense, but as an effects-based inquiry similar to that

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<sup>12</sup> 15 U.S.C. § 1 (2006).

undertaken during the final step of Rule of Reason analysis. Through these comparisons, this Note will demonstrate not only that Delaware courts' treatment of *Unocal* as an ad hoc, effects-based test is a workable and appropriate methodology, but also that Delaware courts are uniquely equipped to employ such a method and can do so without the typical difficulties often attending a case-specific form of review. As a result, this Note offers a unique perspective on the undervalued strength of Delaware's takeover-defense jurisprudence, challenging critics' repeated calls for reform<sup>13</sup> and providing practitioners with valuable insight into the true underlying goals of the law with which they seek to comply.

#### I. THE FOUNDATION OF DELAWARE'S TAKEOVER-DEFENSE JURISPRUDENCE

This Part will begin by briefly summarizing the methodology with which Delaware courts analyze the legality of a takeover defense. It will then discuss the principal cases through which this framework of review developed, focusing on trends in the interpretation of the *Cheff* good-faith requirement, the *Unitrin* ban on preclusiveness, and the *Unocal* proportionality review.

##### *A. Delaware's Takeover-Defense Doctrine—A Brief Overview*

To facilitate this Part's later discussion of the foundational cases in Delaware's takeover-defense jurisprudence, this Section begins with a brief overview of hostile takeovers and a summary of the current framework Delaware courts use to analyze the legality of a corporate board's response to these attacks.

A hostile takeover occurs when a bidder makes an offer, called a tender offer, to purchase a large amount of stock from a corporation's shareholders. If successful, the bidder typically will own enough stock to control the corporation and oust its current corporate officers and board of directors. As a result, corporate boards have a strong incentive to employ takeover defenses, such as "poison pills," to prevent a hostile bidder from succeeding.

To avoid the risk that directors may have selfish motives rather than shareholder welfare at heart when enacting a takeover defense, Delaware

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<sup>13</sup> See supra note 11 and accompanying text.

courts have developed, over the course of thirty years, a three-step framework for determining whether a takeover defense is legal. In general terms, Delaware courts will:

- (1) assess whether the board, when adopting a defense, acted in good faith and after reasonable investigation;
- (2) determine that the defense is not preclusive or subject to certain other restrictive duties, called *Revlon* duties; and
- (3) if both of these conditions are satisfied, review whether a defense is proportional with the threat it was meant to defuse.<sup>14</sup>

Step one's initial requirement of good faith and reasonable investigation was announced in the early case of *Cheff* and compelled directors to demonstrate that their implementation of a takeover defense was motivated by a legitimate and well-documented threat to the corporation and its shareholders.<sup>15</sup> Twenty years later, *Unocal* supplemented this inquiry with step three, which imposed on directors the additional burden of proving that a takeover defense was "reasonable in relation to the threat posed."<sup>16</sup>

After *Unocal*, the doctrine underwent several more modifications that resulted in the ultimate development of an intermediate step two. During this step, the directors first must demonstrate that their defensive tactics are not preclusive, i.e., that given enough shareholder support, a hostile bidder could still take over the corporation even with the takeover defense in place.<sup>17</sup> In addition, directors must show that they did not implement a defensive measure when they were under a duty, called the *Revlon* duty, to maximize the sale price of the corporation.<sup>18</sup> Unless directors are able to make these intermediate showings, a court should hold a takeover defense illegal without progressing to step three's proportionality review.<sup>19</sup>

While this three-step framework seems clear on its surface, the concepts on which it rests, especially good faith, preclusiveness, and proportionality, have resisted straightforward definition and given rise to a

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<sup>14</sup> *Unitrin*, 651 A.2d at 1387–88.

<sup>15</sup> 199 A.2d at 555 .

<sup>16</sup> 493 A.2d at 955 .

<sup>17</sup> *Unitrin*, 651 A.2d at 1387.

<sup>18</sup> *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

<sup>19</sup> *Unitrin*, 651 A.2d at 1387–88.

highly criticized legal doctrine.<sup>20</sup> Sections I.B, C, and D discuss this problem in greater depth by cataloguing the central cases from which Delaware's takeover-defense law has evolved, analyzing the incremental development and doctrinal inconsistencies brought about by each new ruling.

*B. Cheff, Unocal, and Moran—The Birth of Takeover-Defense Review*

The development of the Delaware Supreme Court's takeover-defense jurisprudence began with rules it adopted when addressing the permissibility of defensive greenmail payments.<sup>21</sup> The court, in *Cheff*,<sup>22</sup> sanctioned the payment of greenmail using a form of scrutiny comparable to the highly deferential business judgment rule.<sup>23</sup> For directors to legally make greenmail payments, the Delaware Supreme Court required them only to demonstrate (1) a proper business purpose, i.e., a good-faith reason for their actions; and (2) reasonable investigation, i.e., procedural mechanisms to ensure informed decision making.<sup>24</sup> Applying this rule, the Delaware Supreme Court indicated that as long as the board could link its defensive actions to protecting the corporation from a legitimate threat, and support those actions with the imprimatur of a financial services advisor, those actions would be legal.<sup>25</sup>

In the 1980s, corporate boards, under the growing threat of coercive takeover bids, began to adopt rights plans, derogatorily known as "poison pills," as an alternative to greenmail. These plans relied on dilutive mechanisms to erect a defensive shield around the corporation, forcing

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<sup>20</sup> See supra note 11 and accompanying text.

<sup>21</sup> Greenmail, a play on the word blackmail, occurs when directors use corporate assets to repurchase the stock of a would-be hostile bidder at a higher than market price, preemptively squelching his attempt to acquire the corporation.

<sup>22</sup> 199 A.2d at 556.

<sup>23</sup> See Deborah A. DeMott, *Guests at the Table?: Independent Directors in Family-Influenced Public Companies*, 33 J. Corp. L. 819, 849 n.164 (2008); Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 Bus. Law. 247, 249 (1989).

<sup>24</sup> *Cheff*, 199 A.2d at 555.

<sup>25</sup> DeMott, supra note 23, at 849 n.164 (noting that the *Cheff* requirements are "often surmounted . . . because ordinarily directors are presumed to have acted in good faith, in a sufficiently informed manner, and without conflicting interests"); Gilson & Kraakman, supra note 23, at 249 (arguing that "[b]ecause competent counsel could always document a policy conflict between a would-be acquirer and defending management, the *Cheff* test inevitably reduced to a routine application of the business judgment standard").

raiders to negotiate with the board.<sup>26</sup> In *Unocal*,<sup>27</sup> the corporation employed an early styling of the modern poison pill,<sup>28</sup> a discriminatory self-tender offer, to defend against a hostile bid launched by notorious corporate raider T. Boone Pickens.<sup>29</sup>

When reviewing Unocal's defense, the Delaware Supreme Court, citing *Cheff*, reiterated the proposition that upon a showing of good faith and reasonable investigation, the defensive measures at issue should be evaluated using the business judgment rule.<sup>30</sup> Employing the minimalist review employed in *Cheff*, the *Unocal* court held, with almost no discussion, that the board had satisfied the burden imposed by these two requirements, underscoring how easily a corporate board could pass the *Cheff* test. Before upholding the Unocal board's decision, however, the court also required that the board demonstrate that the defensive measures it adopted were "reasonable in relation to the threat posed."<sup>31</sup>

To this end, the court provided a list of factors to be evaluated in judging the seriousness of the threat posed by a tender offer and the corresponding defenses with which the board could protect its shareholders. The factors required assessment of:

[I]nadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on "constituencies" other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally), the risk of nonconsummation, and the quality

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<sup>26</sup> See Robert A. Prentice, Front-End Loaded, Two-Tiered Tender Offers: An Examination of the Counterproductive Effects of a Mighty Offensive Weapon, 39 Case W. Res. L. Rev. 389, 412–13 (1989).

<sup>27</sup> 493 A.2d at 949.

<sup>28</sup> As it exists today, the modern poison pill typically contains a "flip-in" provision that gives holders of its rights, usually the corporation's existing shareholders (except for the hostile bidder) the ability to purchase additional shares from the corporation at a significant discount upon the occurrence of some trigger event (most often the acquisition of a certain amount of stock by any given shareholder). See Dale A. Oesterle, Delaware's Takeover Statute: Of Chills, Pills, Standstills, and Who Gets Iced, 13 Del. J. Corp. L. 879, 918 (1988). The mass issuance of stock that ensues after the pill is triggered dilutes the value of previously existing shares and thus provides a powerful disincentive for any particular shareholder to acquire the threshold amount. *Id.* at 919. See generally Note, "Poison Pills" as a Negotiating Tool: Seeking a Cease-Fire in the Corporate Takeover Wars, 1987 Colum. Bus. L. Rev. 459, 459–68 (1987) (discussing the various forms of the classic poison pill employed in the early and mid-1980s).

<sup>29</sup> *Unocal*, 493 A.2d at 949 n.1.

<sup>30</sup> *Id.* at 955.

<sup>31</sup> *Id.*

of securities being offered in the exchange . . . [as well as] the basic stockholder interests at stake . . . .<sup>32</sup>

These factors could have been viewed as imposing a universal methodology with which to judge proportionality, standardizing what would otherwise be an incredibly fact-specific inquiry to which courts might take inconsistent approaches.<sup>33</sup> The Delaware Supreme Court's review in *Unocal* itself, however, proved this to be untrue, as the court, after listing its factors, failed to apply them to the facts at hand.<sup>34</sup>

The court began by noting that the type of tender offer employed by Pickens was a "classic coercive measure designed to stampede shareholders" and thus that the Unocal board was right to seek to prevent its consummation.<sup>35</sup> The court then reasoned that because Unocal's defensive tender offer effectively averted the threat of Pickens' coercive offer, it was proportional.<sup>36</sup> The court employed what is most accurately described as an effects-based test, declaring that because the board's defensive measure thwarted Pickens' offer—a goal that the court had approved—the measure was "reasonably related to the threat[] posed."<sup>37</sup>

Due to its imposition of a proportionality requirement, *Unocal* represents an early indication of the Delaware Supreme Court's increased willingness to police more strictly the validity of a board's actions in the specific context of hostile takeover defenses.<sup>38</sup> But the court's ambigu-

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<sup>32</sup> Id. at 955–56.

<sup>33</sup> See James F. Ritter, Comment, *Unocal Corp. v. Mesa Petroleum Co.*, 72 Va. L. Rev. 851, 868–69 (1986) (emphasizing the importance of the standardized factors listed in *Unocal*).

<sup>34</sup> See *Unocal*, 493 A.2d at 956–57.

<sup>35</sup> Id. at 956.

<sup>36</sup> Id.

<sup>37</sup> Id.; see also Mark J. Bernet, et al., Comment, Corporate Law—*Unocal Corp. v. Mesa Petroleum Co.*: The Selective Self-Tender—Fighting Fire With Fire, 61 Notre Dame L. Rev. 109, 123 (1986) (arguing that the Unocal board's actions were permitted only because they were "designed to thwart an inadequate two-tier tender offer," i.e., that they had the effect of protecting shareholders).

<sup>38</sup> See Robert W. Hamilton, The State of State Corporation Law: 1986, 11 Del. J. Corp. L. 3, 10 (1986) (relying on *Unocal* to conclude "that the Delaware court is fashioning a new and more stringent version of the business judgment rule applicable to transactions involving the fundamental ownership rights of shareholders, without changing the traditional business judgment rule for other transactions"); Kenneth B. Pollock, Note, Exclusionary Tender Offers: A Reasonably Formulated Takeover Defense or a Discriminatory Attempt to Retain Control?, 20 Ga. L. Rev. 627, 667 (1986) ("Although the *Unocal* court ultimately exonerated the directors, they did not reach this result through the passive, deferential scrutiny of the traditional business judgment rule. The court instead engaged in a rigorous review of the di-



ous application of its newly announced requirement left unclear how the mechanics of the proportionality test would play out.

In *Moran v. Household International, Inc.*, the Delaware Supreme Court wrestled for the first time with a true poison pill adopted not in response to a specific, concrete, hostile tender offer, but rather based on a general fear of the corporation's vulnerability to tender offers.<sup>39</sup> Using the *Cheff-Unocal* framework, the court found not only that the good-faith requirement was satisfied by a board's *general fear* of tender offers—an even weaker justification than in *Unocal*<sup>40</sup>—but also that the board had demonstrated reasonable investigation by simply reading about the plan before voting.<sup>41</sup>

The court did not, however, forget *Unocal*'s additional proportionality test. Interestingly, though, the court did not separately evaluate each of the discrete factors initially identified in *Unocal*. Rather, the court conflated the *Cheff* test for good faith with the *Unocal* proportionality test by holding that a general fear of two-tier offers—the same factor that satisfied the *Cheff* good-faith requirement—was enough to show that the rights plan was a proportional response:

The record reflects a concern on the part of the Directors over the increasing frequency in the financial services industry of “boot-strap” and “bust-up” takeovers. The Directors were also concerned that such takeovers may take the form of two-tier offers. . . . In sum, the Directors reasonably believed Household was vulnerable to coercive acquisition techniques and adopted a reasonable defensive mechanism to protect itself.<sup>42</sup>

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rectors' decisionmaking process and motives.”). But see Ritter, *supra* note 33, at 872 (“In doctrinal terms, the Delaware Supreme Court's approach raises a new barrier to the directors' invocation of the business judgment rule in tender offer defenses, but the court's application of this new doctrine to the *Unocal* facts suggests that not much has really changed.”).

<sup>39</sup> 500 A.2d 1346, 1348 (Del. 1985).

<sup>40</sup> *Id.* at 1350 (holding that “it seems even more appropriate to apply the business judgment rule” when “reviewing a pre-planned defensive mechanism”). For more detailed insight into the *Moran* court's treatment of the “pre-planning” aspect of Household's poison pill, see E. Norman Veasey, Commentary from the Bar, The New Incarnation of the Business Judgment Rule in Takeover Defenses, 11 Del. J. Corp. L. 503, 507–08 (1986); Daniel S. Cahill & Stephen P. Wink, Note, Time and Time Again the Board is Paramount: The Evolution of the *Unocal* Standard and the *Revlon* Trigger Through *Paramount v. Time*, 66 Notre Dame L. Rev. 159, 168 (1990).

<sup>41</sup> *Moran*, 500 A.2d at 1356.

<sup>42</sup> *Id.* at 1357.

The court validated the Household pill merely because the directors meant for it to protect against a legitimate threat, providing no analysis of the costs the pill exacted for such protection.<sup>43</sup> In essence, as long as there was a threat to justify the pill, its satisfaction of the proportionality test flowed a fortiori from satisfaction of the good-faith requirement.

Most striking is that the court made no attempt to engage in the sort of comparative balancing suggested by *Unocal*'s mandate that a defense be "reasonable in relation to the threat posed."<sup>44</sup> Because *Unocal*'s language suggested a comparison, one would have expected the court to balance the threat to the corporation with the board's defensive response and weigh their relative severities.<sup>45</sup> In *Moran*, however, the court discussed only the threat to the corporation and, having identified one, summarily found the rights plan to be a reasonable response with little discussion of the plan's harshness in light of the factors advanced by the *Unocal* court.<sup>46</sup>

### C. Revlon—*Inevitable Sale and the Duty to Maximize*

Less than a year after the Delaware Supreme Court's decision in *Moran*, it issued another opinion representing a surprising retraction of corporate directors' discretion to implement a takeover defense. In the 1986 case of *Revlon*, the Revlon board received a tender offer, implemented a set of defensive measures to defend against it, and ultimately sold the corporation to a different buyer for a higher price.<sup>47</sup> Upon review of these actions, the Delaware Supreme Court imposed a new set of duties on directors, drawing a distinction between those owed when a board first implements a defensive tactic and those owed when it enters into an agreement to sell the corporation.<sup>48</sup>

With respect to the former, the court held that the standard *Cheff-Unocal* review should guide the analysis. Evaluating the *Revlon* poison

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<sup>43</sup> *Id.*; see also David S. Newman, Delaware Serves Shareholders the "Poison Pill": *Moran v. Household International, Inc.*, 27 B.C. L. Rev. 641, 648 (1986) ("A perceived threat in the marketplace of coercive two-tier tender offers, the court held, was a sufficient threat to justify the Household board's adoption of a poison pill . . .").

<sup>44</sup> *Moran*, 500 A.2d at 1357 (emphasis added).

<sup>45</sup> See Ritter, *supra* note 33, at 868–69 (stressing the importance of the factors laid out in *Unocal* when assessing the relative severities of threat and response during proportionality review).

<sup>46</sup> *Moran*, 500 A.2d at 1357.

<sup>47</sup> 506 A.2d at 179, 181–82.

<sup>48</sup> *Id.* at 182.

pill, the court found that a board's fear of a currently existing, potentially unfair tender offer and its reliance on an investment bank in assessing the offer demonstrated good faith and reasonable investigation.<sup>49</sup> The court also found proportionality, noting that Revlon's poison pill had performed exactly as the board had planned by increasing the final price paid to Revlon's shareholders. "Far from being a 'show-stopper,' as the plaintiffs had contended in *Moran*, the measure spurred the bidding to new heights, a proper result of its implementation."<sup>50</sup>

The court then switched gears, finding that the moment the hostile bidder increased its offer to a point where "it became apparent to all that the break-up of [Revlon] was inevitable," the Revlon board's duties "changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit."<sup>51</sup> Thus, immediately after employing the incredibly liberal standard of *Moran*, the Delaware Supreme Court ramped up the duties owed by a board, at least when sale of the corporation becomes imminent, instituting a new duty with very little flexibility.<sup>52</sup>

The Delaware Supreme Court provided further guidance as to when the *Revlon* duty to maximize shareholder value applied through two additional cases. In the first case, *Paramount Communications, Inc. v. Time, Inc.*, the Delaware Supreme Court refused to find that the *Revlon* duty applied to the directors of Time even after Time's board agreed to a merger with Warner Communications in which Warner would acquire sixty-two percent of Time.<sup>53</sup> Instead of holding that this technical sale

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<sup>49</sup> Id. at 180–81.

<sup>50</sup> Id. at 181. Thus in its proportionality analysis, the court again did not conduct any sort of comparative evaluation of the threat posed and the measure adopted. Instead, if a defensive measure achieved the proper business purpose that the board claimed it was meant to further, it would pass as "reasonable in relation to the threat posed." Id. In a way, this mirrors the *Moran* court's conflation of the proportionality test with the good-faith requirement that there be a valid threat. See supra note 42 and accompanying text. The *Revlon* court, like the court in *Unocal*, simply added the proviso that once a valid threat was shown, the defense must have successfully defused it. See supra note 37 and accompanying text.

<sup>51</sup> *Revlon*, 506 A.2d at 182.

<sup>52</sup> See Cahill & Wink, supra note 40, at 172 (noting that once *Revlon* duties are triggered, "defensive tactics are impermissible as they can bear no relation to a non-existent threat"); Robert W. Rodriguez, Note, Hostile Takeover Contests: The Rise and Fall of Lock-Up Options, 1987 Colum. Bus. L. Rev. 193, 197 (arguing that the "*Revlon* court[] . . . significantly eroded the director's business judgment rule shield").

<sup>53</sup> 571 A.2d 1140, 1146, 1150 (Del. 1989).

triggered *Revlon* duties, the court ruled that *Revlon* duties applied only after the occurrence of one of two more discrete events:

[(1)] 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. . . . [or (2)] 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.<sup>54</sup>

Having found *Revlon* inapplicable, the court went on to consider whether the board's actions met the standard *Cheff* and *Unocal* requirements. The court found that after a reasonable investigation, the board believed in good faith that the Paramount offer would interfere with Time's business plan to merge with Warner, endanger its corporate "culture," and lead its unwitting shareholders to tender at an inadequate price.<sup>55</sup> Given these well-identified threats, the court also found the board's defensive tactics proportional because they ensured the success of the previously planned Warner merger.<sup>56</sup>

Through this ruling, the Delaware Supreme Court significantly trimmed back the scope of the new *Revlon* duty it had announced only a few years earlier,<sup>57</sup> undercutting its viability by raising serious doubts as to its widespread applicability during the corporate sale process.<sup>58</sup> After

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<sup>54</sup> Id. at 1150.

<sup>55</sup> Id. at 1153–54. The court's analysis of good faith and reasonable investigation serves as yet another example of the *Cheff* requirement's toothlessness. See Marc I. Steinberg, Nightmare on Main Street: The *Paramount* Picture Horror Show, 16 Del. J. Corp. L. 1, 19 (1991) (arguing that *Time*'s treatment of the good-faith-and-reasonable-investigation requirement caused "it to resemble the 'plain vanilla' business judgment rule").

<sup>56</sup> *Time*, 571 A.2d at 1155. Note that, as in *Revlon*'s analysis of the poison pill, the *Time* proportionality analysis did not consider the reasonableness of the defensive tactics in relation to the threat posed, but instead asked whether they achieved the director's proper business purpose. Id. (holding the defensive action was reasonable because it "had as its goal the carrying forward of a pre-existing transaction"); see also supra note 50.

*Time* also marks the first instance of the Delaware Supreme Court approving "substantive coercion," i.e., the risk that shareholders would voluntarily tender due to their ignorance of an offer's inadequacy, as a valid threat justifying the use of defensive measures. *Time*, 571 A.2d at 1153 & n.17. Commentators have viewed this as a gift of "almost boundless discretion afforded to the board in determining whether a takeover bid constitutes a threat to corporate policy and effectiveness under *Unocal*[]" . . ." Steinberg, supra note 55, at 20.

<sup>57</sup> See Steinberg, supra note 55, at 15 (characterizing the holding in *Time* as "narrowly construing *Revlon*'s scope").

<sup>58</sup> See Robert E. Bull, Note, Directors' Responsibilities and Shareholders' Interests in the Aftermath of *Paramount Communications v. Time, Inc.*, 65 Chi.-Kent L. Rev. 885, 915 (1989).

*Time*, it seemed that a corporation could shield itself from *Revlon* simply by couching its break-up as part of a long-term plan rather than an abrupt change in strategy.<sup>59</sup>

Five years later, however, the court broadened the scope of the *Revlon* duty in *Paramount Communications, Inc. v. QVC Network, Inc.*<sup>60</sup> Paramount had planned to merge with Viacom and, to ensure the success of this merger, had put several defensive measures in place that made competing bids more difficult to propose. After Paramount announced its merger with Viacom, QVC proposed an alternative merger with Paramount, which the Paramount board effectively rejected by entering into an amended merger agreement with Viacom that was “essentially the same” as the original merger agreement and that left in place all the defensive measures of the original agreement.<sup>61</sup>

The Delaware Supreme Court began by noting that Viacom was controlled by a single shareholder, its CEO Sumner Redstone, and thus that the Paramount-Viacom merger shifted control of Paramount from a “fluid aggregation of unaffiliated stockholders” to a single shareholder holding a control block, triggering *Revlon*.<sup>62</sup> Based on this observation, the court held that Paramount’s directors owed their shareholders a *Revlon* duty to maximize price and that under this duty, Paramount’s defensive measures were illegal.<sup>63</sup>

While the *Time* saga thus began with a significant narrowing of the *Revlon* duty to maximize price, *QVC* expanded that same duty to cover any transaction that would effect a change in the corporation’s control.<sup>64</sup> Along with the initial decision in *Revlon* itself, these three cases are a testament to the fickle nature of Delaware’s takeover-defense jurisprudence, amounting to the announcement of a new duty, the narrowing of that duty, and its subsequent expansion, all within a period of less than ten years.

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<sup>59</sup> See Steinberg, *supra* note 55, at 17; Bull, *supra* note 58, at 915.

<sup>60</sup> 637 A.2d 34, 37 (Del. 1994).

<sup>61</sup> *Id.* at 39–40.

<sup>62</sup> *Id.* at 38, 43.

<sup>63</sup> *Id.* at 48, 50.

<sup>64</sup> See Steven J. Fink, *The Rebirth of the Tender Offer? Paramount Communications, Inc. v. QVC Network, Inc.*, 20 Del. J. Corp. L. 133, 159 (1995) (“Although *QVC* did not overrule *Time*, the court did adopt a broader reading of directors’ duty to maximize stockholder value. *QVC* did not adopt the subjective definition of ‘sale’ used in *Time*; instead, the court reasoned that directors’ intent to auction off the corporation is not a prerequisite to courts imposing this duty on target boards . . .”).

*D. Unitrin—Refining Proportionality and Expanding Good Faith*

The Delaware Supreme Court's next major move was to clarify, and arguably weaken, the requirements of the *Unocal* proportionality test. It did so in the 1995 case of *Unitrin*, in which the Unitrin home insurance corporation adopted both a poison pill and a stock repurchase in response to American General's public tender offer for Unitrin's stock.<sup>65</sup> Unitrin adopted these measures based on its belief that its stock was undervalued in the market and that the American General tender offer was thus meant to dupe Unitrin's unwitting shareholders into tendering at an inadequate price, a threat many academics have termed "substantive coercion."<sup>66</sup>

The Delaware Supreme Court affirmed the Chancery Court's finding that Unitrin's directors had acted in good faith, endorsing substantive coercion as a valid threat.<sup>67</sup> It then added an intermediate step prior to *Unocal* proportionality review, indicating that before a court could determine whether a board's actions were proportional and fell within a "range of reasonableness," it must first assess whether those actions were "draconian."<sup>68</sup>

To elaborate, courts should first evaluate whether a defense is draconian in that it *precludes* shareholders or outside parties from challenging or removing the board, either via a hostile tender offer or other strategy such as waging a proxy contest. If a defense falls into this category, it is automatically illegal and the inquiry ends.<sup>69</sup> If the measure is not draconian, courts should approve the defense as long as it is proportional and thus falls within "a range of reasonableness."<sup>70</sup> In describing what constitutes "reasonableness," the court put forward as a key consideration whether the "defensive response to [the tender offer] was limited and corresponded in degree or magnitude to the degree or magnitude of the threat, (*i.e.*, assuming the threat was relatively 'mild,' was the response relatively 'mild?')."<sup>71</sup>

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<sup>65</sup> 651 A.2d at 1370.

<sup>66</sup> *Id.*; see also Gilson & Kraakman, *supra* note 23, at 267; *supra* note 56.

<sup>67</sup> *Unitrin*, 651 A.2d at 1375, 1391.

<sup>68</sup> *Id.* at 1387–88.

<sup>69</sup> *Id.* at 1387; see also *Mercier v. Inter-Tel (Del.) Inc.*, 929 A.2d 786, 810–11 (Del. Ch. 2007) (reemphasizing *Unitrin* step one by stating that a defensive tactic must "not *preclude* the stockholders from exercising their right to vote or *coerce* them into voting a particular way" (emphasis added)).

<sup>70</sup> *Unitrin*, 651 A.2d at 1389.

<sup>71</sup> *Id.*

*Unitrin*'s renewed focus on degree and magnitude during the range-of-reasonableness inquiry suggested a return to true proportionality during the final stage of *Unocal* analysis, requiring a court to actually ask whether a defensive tactic was proverbial "overkill." Yet the court's discussion of *Unitrin*'s stock repurchase plan indicated that it passed proportionality review even though the court admitted in the same breath that *Unitrin*'s other defense, a poison pill, would alone have gotten the job done.<sup>72</sup> Thus, while the court's range-of-reasonableness language could have sparked a revival of genuine proportionality review, it ultimately amounted to nothing more than a rebranding of the same standardless *Unocal* test.<sup>73</sup>

## II. WHO'S COUNTING? DELAWARE'S COMEDY OF ERRORS IN REVIEW

The swings in Delaware's corporate jurisprudence outlined above have led to widespread feeling that there is little prospective utility provided by the Delaware courts' instructions.<sup>74</sup> Relying on the observations of Part I, this Part will draw out the three most dominant of these so-called inconsistencies, laying the foundation for their resolution in Section III.B.

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<sup>72</sup> *Id.* at 1388–89.

<sup>73</sup> *Id.* at 1385–86 (stating that when assessing the proportionality of a response, "a court applying enhanced judicial scrutiny should be deciding whether the directors made a *reasonable* decision, not a *perfect* decision" (quoting *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 45 (Del. 1993)); see also Robert A. Ragazzo, *Unifying the Law of Hostile Takeovers: The Impact of QVC and Its Progeny*, 32 *Hous. L. Rev.* 945, 981 (1995) ("[S]ome of the court's language suggests that *Unitrin* not only accepts but extends the trend of prior *Unocal* cases that seemed to require little in the way of proportionality."); Gregory W. Werkheiser, *Comment, Defending the Corporate Bastion: Proportionality and the Treatment of Draconian Defenses from Unocal to Unitrin*, 21 *Del. J. Corp. L.* 103, 104 (1996) (arguing that while *Unitrin*'s preclusiveness analysis narrowed directors' permissible actions by creating "expressly defined limits on a board's authority to displace shareholder choice," *Unitrin*'s range-of-reasonableness analysis conversely "grant[ed] a board greater discretion to act within the parameters of that authority").

<sup>74</sup> See William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 *U. Chi. L. Rev.* 1067, 1069–70 (2002); Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 *Cornell L. Rev.* 1205, 1236–40 (2001); see also Black & Kraakman, *supra* note 11, at 521; Velasco, *supra* note 11, at 390–97.

*A. Unocal's Enigmatic Proportionality Review*

Ever since the Delaware Supreme Court debuted *Unocal* proportionality review in 1984, its application has been criticized as unpredictable. The language employed by the court, that the defensive measures under review must be “reasonable in relation to the threat posed,” suggested its desire that reviewing courts conduct a balancing test, weighing the severity of the threat and ensuring that the defenses adopted be roughly equivalent in magnitude.<sup>75</sup> Nonetheless, Delaware courts have consistently failed to engage in a substantive balancing of threats and responses or to supply any real conversion ratios that translate the danger of a given threat into units of reasonable response.<sup>76</sup> Given a closer look, Delaware’s takeover-defense opinions have applied *Unocal* proportionality in several different ways, none of which resemble the uniform balancing test one might expect.

Some applications of *Unocal* proportionality review have found that the existence of a legitimate threat to a corporation is enough to make a defensive response proportional, with no discussion of the defense or how it compares with the threat.<sup>77</sup> These cases conflate the good-faith requirement of *Cheff*, i.e., that a legitimate threat exists, with *Unocal*’s proportionality requirement.<sup>78</sup> While the latter could be viewed as a further inquiry into whether, even in the presence of a threat, the defensive tactic adopted was reasonable,<sup>79</sup> these courts endorse any defense so long as it was preceded by a threat.

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<sup>75</sup> *Unocal*, 493 A.2d at 955; see also Ritter, *supra* note 33, at 868. Indeed, in reiterating *Unocal* proportionality ten years later, the *Unitrin* court stated that “a defensive response [must be] limited and correspond[] in degree or magnitude to the degree or magnitude of the threat, (i.e., assuming the threat was relatively ‘mild,’ was the response relatively ‘mild?’).” *Unitrin*, 651 A.2d at 1389. Thus, that court made clear that “the nature of the threat associated with a particular hostile offer sets the parameters for the range of permissible defensive tactics,” implying that a direct comparison of the severity of threat and response is not only helpful, but essential to the analysis. *Id.* at 1384.

<sup>76</sup> See McGinty, *supra* note 7, at 270 (noting that “Delaware courts have struggled unsuccessfully to find an appropriate proxy for assessing threat and proportionality”).

<sup>77</sup> See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 181 (Del. 1986) (applying the same logic when analyzing Revlon’s stock buy-back plan); *Moran v. Household Int’l, Inc.*, 500 A.2d 1346, 1357 (Del. 1985); see also *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 35 (Del. Ch. 2010) (reaching the complementary conclusion that in the absence of a true threat, no defense would be reasonable).

<sup>78</sup> See *supra* note 42 and accompanying text.

<sup>79</sup> See *eBay*, 16 A.3d at 30 (reiterating that “even when acting *subjectively* in good faith, *Unocal* and its progeny require that this Court also review the use of a rights plan *objectively*”).



A second group of opinions follows a similar line of reasoning but also accounts for a defensive tactic's success when analyzing whether the tactic was proportional.<sup>80</sup> Of course, this approach could seem quite appropriate if proportionality review were understood to be an ad hoc, effects-based analysis of a specific defense's ability to thwart a legitimate threat. But the Delaware Supreme Court's express framing of *Unocal* review as an evaluation driven by standardized factors and magnitude-driven comparisons could be read to require a more uniform approach—one divorced from individually tailored, ex post assessments of efficacy.<sup>81</sup>

Finally, several post-*Unitrin* opinions have engaged only in the preliminary step of assessing preclusiveness and have ignored the balancing at the heart of *Unocal*'s step two.<sup>82</sup> Thus, these courts have conflated a finding of nonpreclusiveness with a finding of proportionality, holding that if a defense is not preclusive, it is always proportional.<sup>83</sup> While the language of *Unitrin* does not support this reasoning, a few courts have stumbled, at least in their language, into the fallacy that nonpreclusive equals proportional.

### *B. Elusive Preclusiveness*

In the mid-90s, *Unitrin* attempted to reinvigorate *Unocal* analysis by adding a preliminary step banning preclusive defenses as per se illegal.<sup>84</sup> Newer cases, however, have waffled on what constitutes a "preclusive" defense. These cases have tended to focus on whether the defensive mechanisms imposed by a poison pill, while thwarting a hostile bidder's tender offer, would still allow the bidder to conduct a proxy contest and

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<sup>80</sup> See, e.g., *Versata Enters., v. Selectica, Inc.*, 5 A.3d 586, 605–06 (Del. 2010); *Unitrin*, 651 A.2d at 1388–89; *Paramount Commc'ns, Inc. v. Time, Inc.*, 571 A.2d 1140, 1155 (Del. 1989); *Revlon*, 506 A.2d at 181 (analyzing Revlon's poison pill); *Unocal*, 493 A.2d at 956.

<sup>81</sup> See Ritter, *supra* note 33, at 868–69. In addition to failing to promote a consistent framework for review, focusing only on the success of a given defensive tactic does nothing to ensure that such success came at a reasonable price. Of course, an effects-based test might not concern itself with the costs of a defense as long as its net effects were proshareholder, but a proportionality review certainly would take such costs into account.

<sup>82</sup> See, e.g., *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 124 (Del. Ch. 2011); *Yucaipa Am. Alliance Fund II v. Riggio*, 1 A.3d 310, 353, 360 (Del. Ch. 2010).

<sup>83</sup> See *Airgas*, 16 A.3d at 124; *Yucaipa*, 1 A.3d at 353 ("What is left is the related question of whether the Rights Plan is a reasonable response to that ongoing threat. Here, the key issue is whether the Rights Plan unreasonably inhibits the ability of Yucaipa to run an effective proxy contest.").

<sup>84</sup> *Unitrin*, 651 A.2d at 1387.

thus gain control of the corporation via a lengthier but equally effective strategy.<sup>85</sup>

To this end, the Chancery Court recently held that a defensive measure was preclusive only if it imposed a “herculean lift” on waging a proxy battle.<sup>86</sup> Only months later, however, the Delaware Supreme Court imposed a more exacting standard, holding that even if a poison pill allowed for the mathematical possibility of a successful proxy contest, the pill would still be labeled preclusive if such success looked “realistically unattainable.”<sup>87</sup> Yet in the same opinion, the court endorsed a defense consisting of a staggered board and a poison pill, thought by many to be a near absolute bar on proxy contests, as nonpreclusive.<sup>88</sup>

Thus, while *Unitrin*’s baseline rule against preclusive defenses has retained its clarity throughout the years, the Delaware courts’ inability to accurately define “preclusiveness” has arguably created a degree of uncertainty as to when the *Unitrin* prohibition applies.

### C. The Shifting Contours of Good Faith

Recent cases have also shown uncertainty on the part of the Chancery Court as to what sort of threat will satisfy *Cheff*’s requirement that a board act in good faith. In *eBay Domestic Holdings, Inc. v. Newmark*, the Chancery Court, in a position contrary to *Paramount Communications, Inc. v. Time, Inc.*, held that a threat to corporate culture alone would not satisfy the good-faith requirement.<sup>89</sup> The opinion distinguished *Time* by noting that *Time*’s corporate culture led to “value for stockholders.”<sup>90</sup> In *eBay*, however, the defendant directors, claiming a corporate culture of philanthropy, had failed to show “a sufficient connection between [charitable] ‘culture’ . . . and the promotion of stockholder value.”<sup>91</sup> The Chancery Court thus tightened the good-faith requirement, severely limiting directors’ ability to justify defensive actions

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<sup>85</sup> See *Versata*, 5 A.3d at 604; *Airgas*, 16 A.3d at 115; *Yucaipa*, 1 A.3d at 354.

<sup>86</sup> *Yucaipa*, 1 A.3d at 354.

<sup>87</sup> *Versata*, 5 A.3d at 601.

<sup>88</sup> *Id.* at 604; see also *Airgas*, 16 A.3d at 115 (endorsing the same defensive tactic).

<sup>89</sup> 16 A.3d 1, 32–33 (Del. Ch. 2010).

<sup>90</sup> *Id.* at 33.

<sup>91</sup> *Id.* at 34 (“The corporate form in which [the defendant corporation] operates . . . is not an appropriate vehicle for purely philanthropic ends, at least not when there are other stockholders interested in realizing a return on their investment.”).

with the preservation of corporate culture, especially if directors cannot directly tie that culture to shareholder benefits.

Yet only months later, the Chancery Court's decision in *Air Products & Chemicals, Inc. v. Airgas, Inc.* relaxed the requirements of *Cheff* good faith, reaffirming that the risk of substantive coercion was a valid threat justifying the use of a takeover defense.<sup>92</sup> In *Airgas*, the board argued that "a large percentage" of its current owners were "merger arbitrageurs" who would tender to a hostile bidder despite Airgas's potential to realize a higher long-term profit.<sup>93</sup> As a result, those shareholders truly interested in realizing Airgas's long-term value would be "coerced" to go along and sell their shares at an inadequate price. The court, noting *Unitrin*'s ruling that a board could "protect its stockholders from offers that do not reflect the long-term value of the corporation," found that this risk satisfied *Cheff*'s good-faith requirement.<sup>94</sup>

Thus, while *eBay* rejected the protection of corporate "culture" as a proper justification for implementing a takeover defense,<sup>95</sup> *Airgas* endorsed the similarly ephemeral danger of "substantive coercion" as a valid threat against which directors could defend,<sup>96</sup> again giving critics a chance to highlight the allegedly fickle nature of the Delaware courts.

### III. TOWARDS A UNIFIED DOCTRINE—ANTITRUST LAW'S APPLICATION TO TAKEOVER DEFENSES

This Part attempts to reconcile the issues catalogued in Part II by drawing parallels between Delaware's takeover-defense doctrine and antitrust law's familiar Rule of Reason framework. In doing so, it will seek

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<sup>92</sup> 16 A.3d at 54, 111–12. For a discussion of substantive coercion and commentators' view that its endorsement is a gift of nearly unlimited discretion to directors, see *supra* notes 56, 66 and accompanying text.

<sup>93</sup> *Airgas*, 16 A.3d at 109. In a charmingly poetic turn of phrase, the *Mercier* court described this impulse of the arbitrageur as a willingness to "take a smaller harvest in the swelter of August over a larger one in Indian Summer." *Mercier v. Inter-Tel (Del.), Inc.*, 929 A.2d 786, 815 (Del. Ch. 2007).

<sup>94</sup> *Airgas*, 16 A.3d at 111–12 (quoting *Unitrin*, 651 A.2d at 1376); see also Stanley Keller, Delaware Court of Chancery Gets *Airgas* Right, Harv. L. Sch. F. on Corp. Governance & Fin. Reg., Mar. 1, 2011, <http://blogs.law.harvard.edu/corpgov/2011/03/01/delaware-court-of-chancery-gets-airgas-right> (supporting *Airgas*'s endorsement of substantive coercion in the arbitrage context because it allows directors to "provide the essential check" on the interests of short-term investors seeking to "control the outcome" of a tender offer "at the expense of . . . long-term interests").

<sup>95</sup> *eBay*, 16 A.3d at 32–33.

<sup>96</sup> *Airgas*, 16 A.3d at 111–12.

to unify the otherwise discordant notes struck in the past thirty years into a more harmonized jurisprudential chord. Section III.A begins by providing a brief explanation of the Rule of Reason. Section III.B will then draw on the mechanics of antitrust analysis to argue that Delaware courts are actually applying a modified Rule of Reason framework in their assessment of takeover defenses. This unique reframing of Delaware's takeover doctrine not only discredits the criticisms of academic commentators and their recurrent demands that Delaware adopt predictable, bright-line rules,<sup>97</sup> but also provides attorneys and corporate directors with a clearer picture of the hurdles they must clear to justify a takeover defense.

*A. Antitrust Law's Evaluation of Restraints on Trade—The Rule of Reason*

Section 1 of the Sherman Act states that “[e]very contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.”<sup>98</sup> Of course, the Supreme Court quickly realized that many agreements that could literally be construed as restraining trade were perfectly legal. It quickly added to the Sherman Act's prohibition the judicial gloss that only agreements *unreasonably* restraining trade, later clarified to mean anticompetitive agreements, were illegal.<sup>99</sup>

From this acknowledgement that some agreements restraining trade were still of value to society due to their overall procompetitive effects on the market, the Supreme Court developed its Rule of Reason analysis. One of the clearest elucidations of the mechanics by which the Court applies the Rule of Reason to evaluate the legality of a restraint on trade appears in Justice Breyer's concurrence in *California Dental Ass'n v. FTC*.<sup>100</sup> According to Justice Breyer, the analysis should proceed as follows:

- (1) the plaintiff must identify the restraint on trade;
- (2) the plaintiff must identify the restraint's likely anticompetitive effects;

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<sup>97</sup> See *supra* notes 11, 74 and accompanying text.

<sup>98</sup> 15 U.S.C. § 1 (2006).

<sup>99</sup> See *Standard Oil Co. v. United States*, 221 U.S. 1, 58 (1911).

<sup>100</sup> 526 U.S. 756, 781–82 (1999) (Breyer, J., concurring in part and dissenting in part).

(3) the defendant must justify the restraint with offsetting procompetitive effects;

(4) the court then balances these effects, along with the parties' market power, to determine the ultimate impact the restraint will have on the marketplace.<sup>101</sup>

Thus, the Rule of Reason is a series of burden-shifting tests, which, if met, leave courts with the responsibility of assessing whether the restraint is, on the whole, good for the market.<sup>102</sup> If its overall effects foster competition, the restraint will be upheld; if not, the restraint will be invalidated. The Supreme Court has never laid down a specific methodology to be applied during this final balancing step, and the outcomes of many cases turn on case-specific information and unique factors that have significance only within the confines of a given state of facts.<sup>103</sup>

In addition, some restraints, such as horizontal price-fixing and market allocation, have been held to be per se illegal and thus are excluded from the later stages of the Rule of Reason analysis.<sup>104</sup> Once a plaintiff proves the existence of a per se illegal restraint, the anticompetitive danger of the restraint is deemed so great that a court may not entertain evidence of its procompetitive effects or engage in the usual Rule of Rea-

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<sup>101</sup> Id. at 782.

<sup>102</sup> See Thomas C. Arthur, A Workable Rule of Reason: A Less Ambitious Antitrust Role for the Federal Courts, 68 Antitrust L.J. 337, 359 (2000) ("Under the [Rule of Reason], the plaintiff has the burden of establishing anticompetitive effects. Usually, this includes a full market analysis, including proof of defendants' collective market power, but in some cases may be limited to proof of actual anticompetitive effects. If the plaintiff meets this burden of production, the defendant must then justify the restraint by showing that it promotes a procompetitive objective. The plaintiff may in turn rebut this showing by demonstrating that a less restrictive alternative could have been used.").

<sup>103</sup> *Cal. Dental*, 526 U.S. at 780 ("There is always something of a sliding scale in appraising reasonableness, but the sliding scale formula deceptively suggests greater precision than we can hope for . . . Nevertheless, the quality of proof required should vary with the circumstances.") (quoting P. Areeda, Antitrust Law 402, para. 1507 (1986)); see also Arthur, supra note 102, at 362 ("The practical lesson of [*California Dental*] may be that for restraints other than those *the Court* has previously condemned under a per se rule or an abbreviated rule of reason, the only safe course is to engage in an extensive inquiry into the 'circumstances, details and logic' of the challenged restraint—in short, the full-blown version of the rule of reason." (quoting *Cal. Dental*, 526 U.S. at 781)).

<sup>104</sup> See, e.g., *United States v. Topco Assocs.*, 405 U.S. 596, 608 (1972) (holding that an allocation of market territories between horizontal competitors is per se illegal); *United States v. Trenton Potteries Co.*, 273 U.S. 392, 397–98 (1927) (ruling that price-fixing is per se illegal despite the reasonableness of the chosen price).

son balancing.<sup>105</sup> Due to the harsh effects of the per se label, the Supreme Court has emphasized that per se treatment “is appropriate only after courts have had considerable experience with the type of restraint at issue and only if courts can predict with confidence that it would be invalidated.”<sup>106</sup> In recent years, the Supreme Court has greatly scaled back the number of per se illegal restraints, acknowledging that many actions initially believed to be purely anticompetitive have the potential to yield beneficial effects and thus require the Rule of Reason’s more involved analysis before they may be condemned.<sup>107</sup>

While the Supreme Court has tried to adhere to these categories, it has also emphasized that the level of detail with which a court should analyze the facts, and the considerations on which it should rely in its balancing, must be “meet for the case, looking to the circumstances, details, and logic of a restraint.”<sup>108</sup> Thus, while the Rule of Reason provides a procedural framework to create a fairly standardized process of review, it also provides courts with the flexibility to rely on any number of different factors that could shed light on the true effects of a given restraint.<sup>109</sup>

### *B. Delaware’s Takeover-Defense Jurisprudence—Just a Modified Rule of Reason?*

This Section will demonstrate the striking similarities between Delaware courts’ application of their takeover-defense law and the Supreme Court’s analysis under the Rule of Reason. By positing that Delaware’s approach to evaluating takeover defenses is, at its core, a series of burden-shifting tests followed by a case-specific inquiry into the propriety of a board’s actions, this Section will suggest that many of the so-called flaws in Delaware’s decisions actually fit neatly within a more flexible analytical framework and represent a completely natural means of re-

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<sup>105</sup> See *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958).

<sup>106</sup> *Leegin Creative Leather Prods., Inc. v. PSKS, Inc.*, 551 U.S. 877, 886–87 (2007) (internal citations omitted).

<sup>107</sup> See, e.g., *id.* at 889; *State Oil v. Khan*, 522 U.S. 3, 22 (1997); *NCAA v. Bd. of Regents*, 468 U.S. 85, 100–02 (1984); *Broad. Music, Inc. v. Columbia Broad. Sys., Inc.*, 441 U.S. 1, 9–10 (1979); *Cont’l T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 57 (1977); see also *Polk Bros. v. Forest City Enters.*, 776 F.2d 185, 188–90 (7th Cir. 1985); Willard K. Tom & Chul Pak, *Toward a Flexible Rule of Reason*, 68 *Antitrust L.J.* 391, 421–22 (2000) (discussing the narrowing of per se rules that began during the 1970s in cases like *Broadcast Music*).

<sup>108</sup> *Cal. Dental*, 526 U.S. at 781.

<sup>109</sup> See *supra* note 103 and accompanying text.

solving highly fact-intensive disputes. The Section concludes that the context-specific nature of takeover litigation and the unique substantive and procedural advantages of the Delaware courts make Delaware's effects-based approach highly preferable to a rigidly rule-based methodology. In doing so, this Section refutes the criticisms of those seeking doctrinal reform<sup>110</sup> and sheds light on ways for practitioners optimally to engage this system of review.

### *1. A Basic Explanation*

The primary motivation of antitrust law is to foster competition in order to promote consumer welfare,<sup>111</sup> while corporate law has, at its core, the goal of ensuring that directors act in a way that will ultimately benefit shareholders.<sup>112</sup> The parallel between Delaware takeover-defense doctrine and antitrust law's Rule of Reason likely assumes form by analogizing the two dangers, restraints on trade and takeover defenses, that could operate to thwart these respective purposes. Restraints on trade run the risk of creating anticompetitive distortions in the market that harm consumers, while takeover defenses have a similar potential to prevent a hostile bid from occurring, to the detriment of the target corporation's shareholders. Like a restraint on trade, directors' defensive ac-

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<sup>110</sup> See *supra* notes 11, 74 and accompanying text.

<sup>111</sup> See John B. Kirkwood & Robert H. Lande, *The Fundamental Goal of Antitrust: Protecting Consumers, Not Increasing Efficiency*, 84 *Notre Dame L. Rev.* 191, 192 (2008) (asserting that "[t]he fundamental goal of antitrust . . . is to protect consumers in the relevant market from anticompetitive behavior that exploits them"). But see Michael S. Jacobs, *An Essay on the Normative Foundations of Antitrust Economics*, 74 *N.C. L. Rev.* 219, 242 (1995) (noting a different school of thought that defines "consumer welfare" more broadly than Kirkwood & Lande and that would pursue this welfare through the promotion of allocative efficiency). While the debate about the true purpose of antitrust law is outside the scope of this Note, it will suffice to say that both sides see review of restraints on trade as serving the interests of "consumer welfare."

<sup>112</sup> See Theodor Baums & Kenneth E. Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, 53 *Am. J. Comp. L.* 31, 31 (2005) ("[C]ontemporary corporate law is supposed to have as a central objective the protection of shareholder interests in the management-controlled firm, and judges have often affirmed the importance of maximizing shareholder value."); Henry Hansmann & Reinier Kraakman, *Essay, The End of History for Corporate Law*, 89 *Geo. L.J.* 439, 439 (2001) ("There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."); Brian M. McCall, *The Corporation as Imperfect Society*, 36 *Del. J. Corp. L.* 509, 521 (2011) (noting that whether one takes the view that corporate law is "rooted in property or contractarian principles, the shareholder primacy conclusion is certainly the dominant conception of the corporation today").

tions can chill the market for corporate shares, both directly, by preventing hostile bidders from purchasing stock via a tender offer, and indirectly, by discouraging bidders' efforts before they begin.<sup>113</sup> On the other hand, takeover defenses can safeguard shareholders from furtive threats like bidder coercion and self-ignorance.<sup>114</sup> Thus, both antitrust and Delaware takeover-defense law attempt to evaluate behavior that could harm, but also potentially benefit, consumers and shareholders, with the ultimate goal of determining which of these two outcomes will ensue.

From there, the takeover plaintiff must explain why these defenses prevent him from tendering his stock and create shareholder harm, just as the antitrust plaintiff must demonstrate some anticompetitive effect. Admittedly, this second step is not as heavily focused upon in takeover disputes, as the poisonous effects of rights plans and other takeover defenses are widely understood at this stage in the law's development. Still, a court obviously would not entertain a takeover suit in which the plaintiff could not make a prima facie showing that the directors' actions were defensive, i.e., meant to disrupt a tender offer.<sup>115</sup>

After the pleading of a set of defensive tactics that could obstruct a tender offer, the first step in the *Cheff-Unocal* analysis shifts the burden to a corporation's directors to establish that their defenses were adopted in good faith and after reasonable investigation.<sup>116</sup> This step easily maps onto the Rule of Reason's second procedural requirement that the defendant allege some offsetting procompetitive effect to justify its actions. After all, the requirement of good faith mandates that a board have a proper business purpose for adopting its defenses, i.e., that it has identified a legitimate threat to the corporation and adopted its defenses to defuse this threat and promote shareholder welfare. Similarly, the reasonable-investigation requirement further promotes shareholder welfare by ensuring that the directors' good-faith belief in a valid threat is based upon reliable information.

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<sup>113</sup> See generally William W. Bratton & Michael L. Wachter, The Case Against Shareholder Empowerment, 158 U. Pa. L. Rev. 653, 680 n.97 (2010) (assembling a diverse collection of recent articles discussing the various effects of takeover defenses).

<sup>114</sup> See *id.*

<sup>115</sup> See *Unitrin*, 651 A.2d at 1374–75 (stating that the burden of proving compliance with *Unocal* shifted to the Board only after a court “concluded that the Board’s actions were defensive”).

<sup>116</sup> See *id.* at 1375.



Just as the antitrust defendant will risk summary judgment if it can provide no plausible explanation as to why its actions actually foster competition, so will the corporate board face defeat if it cannot explain why its actions provide some shareholder benefit. If a corporation's board cannot articulate a legitimate threat to its shareholders, it has no reason to enact defenses in the first place, and a court need not waste its time determining whether the board's defensive actions ultimately would benefit shareholders.<sup>117</sup> In contrast, once the board satisfies the good-faith requirement by articulating a legitimate threat, a court, persuaded that the directors were acting with a proper business purpose, has reason to examine the board's actions further and determine their ultimate effect on shareholders.<sup>118</sup>

Before getting the benefit of *Unocal*'s full proportionality review, however, directors must also show that their actions did not violate *Revlon* duties or constitute preclusive tactics. If *Revlon* duties apply, a board automatically breaches its fiduciary duties by taking any action that fails to maximize sale price;<sup>119</sup> similarly, strict liability ensues when a board institutes a truly preclusive tactic.<sup>120</sup> This formulaic condemnation of these two specific defensive responses mirrors federal courts' classification of certain restraints on trade as per se illegal. Thus, Delaware courts' use of *Revlon* duties and the preclusiveness analysis can simply be viewed as a means of foreclosing directors' claims that certain actions, which courts view as per se harmful, can nevertheless be justified by their alleged proshareholder effects.

Once the board has passed *Cheff-Unocal* step one and survived *Revlon* and preclusiveness analysis, it still must demonstrate that its response was reasonable in relation to the threat posed to its shareholders.<sup>121</sup> As discussed above in Section II.A, this requirement has not developed in the way the *Unocal* court suggested it might—there has been little attempt to employ a standardized, multi-factor test that might add at least a semblance of predictability to the analysis. Even excusing the absence of such a factor-based analysis, Delaware's courts have strug-

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<sup>117</sup> See *Unocal*, 493 A.2d at 955 (noting that a board's fiduciary duty to protect shareholders from the threat of harm empowers it to defend against takeovers, but only when a board has "reasonable grounds" to believe that a takeover presents a true threat).

<sup>118</sup> *Id.*

<sup>119</sup> See *Revlon*, 506 A.2d at 182.

<sup>120</sup> See *Unitrin*, 651 A.2d at 1387.

<sup>121</sup> *Id.* at 1387–88.

gled to pinpoint the most critical shared characteristics of oft-faced threats and commonly employed defenses and have failed to explain exactly why certain defensive measures are equal in magnitude to certain takeover threats.<sup>122</sup>

This deficiency, however, does not seem nearly as problematic if one views *Unocal* proportionality review as simply an ad hoc analysis of the overall effects of a defense for a given set of facts—similar to the sort of review conducted under the Rule of Reason. Antitrust law’s effects-based emphasis on whether the net effect of a given restraint will be pro- or anti-competitive, and thus on whether it will harm or benefit consumers, seems equally appropriate in the takeover-defense context and could explain why the Delaware courts have applied a similar approach. Rather than focusing on the precise relationship between the threat posed, the defense adopted, and their comparative severities, Delaware courts could just be employing an effects-based test during the *Unocal* proportionality stage of review, asking only whether the defense adopted ultimately benefits corporate shareholders.

## 2. Cheff Duties as a Demonstration of Proshareholder Effects

The Delaware courts’ inconsistent stance on what qualifies as a proper business purpose satisfying the *Cheff* requirement of good faith, discussed in Section II.C, appears quite logical if one views the duties of good faith and reasonable investigation merely as the directors’ burden of demonstrating that their actions benefit shareholders. Rather than announcing that certain threats always satisfy the duty of good faith while others never adequately do so, the court could simply be evaluating whether the directors are able to suggest any plausible proshareholder justification for their actions.

For example, the courts’ swing in opinion between *Time* and *eBay* as to whether the protection of corporate “culture” was a valid business purpose can be explained as a fact-specific determination that protection of culture would benefit shareholders in the case of *Time* but would yield little positive result in the case of *eBay*. In *Time*, the court focused on the fact “that Time shareholders might elect to tender into Paramount’s cash offer in ignorance or a mistaken belief of the strategic benefit which a business combination with Warner might produce,” emphasizing its belief that culture protection was for the shareholders’

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<sup>122</sup> See *supra* Section II.A.

benefit.<sup>123</sup> The *eBay* court focused on the same shareholder-welfare inquiry, noting that the board had “failed to prove that [its corporation] possess[ed] a palpable, distinctive, and advantageous culture that sufficiently promote[d] stockholder value.”<sup>124</sup>

Similarly, the *Airgas* court’s holding that a board’s fear of substantive coercion satisfied the good-faith requirement can be directly linked to shareholder benefits. The court emphasized that it would only endorse substantive coercion as supporting a claim of good faith if it were certain that the “[hostile tender] offer is indeed inadequate,” otherwise there would be no threat to shareholder value.<sup>125</sup> Again, the court can be seen as simply assessing whether the directors can demonstrate sufficiently plausible proshareholder effects to satisfy the initial burden of good faith before advancing to *Unocal* proportionality review.

### 3. *Revlon* and *Unitrin*—*Per Se* Parallels

After demonstrating good faith, but before transitioning to the heart of *Unocal* proportionality analysis, directors must further show that they were not under a duty to maximize the corporation’s sale price (the *Revlon* duty) and that their actions were not preclusive.<sup>126</sup> As discussed above in Section III.A, courts enforcing the antitrust laws have treated certain restraints as *per se* illegal and refused to entertain a defendant’s claim that they have procompetitive effects.<sup>127</sup> In the same way, Delaware courts’ approach to the *Revlon* duty and preclusiveness analysis can be viewed as the condemnation of certain actions as *per se* illegal despite a board’s arguments that such actions were taken for the benefit of shareholders.

#### a. *The Revlon Duty*

In the context of *Revlon* duties, the Delaware Supreme Court has made clear that once the break-up of a corporation becomes imminent, defensive measures thwarting the maximization of that corporation’s sale price are *per se* illegal.<sup>128</sup> Directors are not free to argue that their

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<sup>123</sup> *Time*, 571 A.2d at 1153.

<sup>124</sup> *eBay*, 16 A.3d at 33.

<sup>125</sup> *Airgas*, 16 A.3d at 109.

<sup>126</sup> See *Unitrin*, 651 A.2d at 1387; *Revlon*, 506 A.2d at 182.

<sup>127</sup> See *supra* Section III.A.

<sup>128</sup> *Revlon*, 506 A.2d at 182.

actions were undertaken for the benefit of shareholders and then seek to prove these claims under *Unocal*'s Rule of Reason–like proportionality test. Instead, *Revlon* duties, premised on the directors' duty of good faith to "obtain[] the highest price for the benefit of the stockholders," preclude this more expansive analysis and adopt an all-or-nothing view of a defense's legality that closely mirrors the treatment of a per se illegal antitrust restraint.<sup>129</sup>

The Delaware courts' sometimes inconsistent view as to when *Revlon* duties apply<sup>130</sup> does nothing to diminish their similarity to antitrust law's label of per se illegality. Even in the antitrust context, the court must first conduct an investigation into whether a per se restraint, such as horizontal price fixing, exists, before condemning the restraint as per se illegal.<sup>131</sup> In recent years, courts have even reexamined traditionally per se illegal antitrust restraints and dramatically scaled back on the application of the per se label.<sup>132</sup> Thus, Delaware courts' use of a flexible standard rather than a rule to determine when a corporate board's defensive measures fall into *Revlon*'s class of per se defenses is not only consonant with the use of a categorical prohibition, but also appropriate given the harsh consequences that attend such categorization.

*b. Preclusiveness Analysis*

In *Unitrin*, the Delaware Supreme Court also reinforced its view that preclusive defensive measures are per se illegal. Again, these sorts of defenses do not even reach evaluation under the *Unocal* proportionality test, but, like antitrust law's per se restraints, are rejected after failing to clear this preliminary hurdle.<sup>133</sup>

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<sup>129</sup> *Id.*

<sup>130</sup> See *id.* (applying a duty to maximize sale price when "the break-up of [a] company [is] inevitable"); see also *Paramount Commc'ns, Inc. v. QVC Network, Inc.*, 637 A.2d 34, 48 (Del. 1993) (finding *Revlon* duties apply when there is a "shift [in] control of [the corporation] from the public stockholders to a controlling stockholder"); *Time*, 571 A.2d at 1150 (holding that *Revlon* duties do not apply any time there is an imminent sale of a corporation, but only "when a corporation initiates an active bidding process . . . involving a clear breakup of the company" or "where, in response to a bidder's offer, a target abandons its long-term strategy and seeks . . . the breakup of the company").

<sup>131</sup> See Arthur, *supra* note 102, at 362 (stating that before engaging in any sort of analysis, a court must make the preliminary determination of "[w]hich restraints call for which inquiry").

<sup>132</sup> See *supra* note 107 and accompanying text.

<sup>133</sup> See *Unitrin*, 651 A.2d at 1387.

Admittedly, there has been continuing development and mild upheaval in the case law as to when a defense qualifies as preclusive.<sup>134</sup> But this sort of taxonomical confusion as to the status of a given defense is far from unusual (and actually, quite common) in the context of per se classifications. Antitrust courts are constantly redefining the contours of per se restraints and even excepting certain restraints arising in unique circumstances.<sup>135</sup> Thus, while Delaware courts may use an appropriately fact-dependent standard to define the term “preclusive,” any defense so-labeled will still automatically be deemed illegal.

#### 4. *Unocal’s Role as an Effects-Based Test*

Moving to the Delaware courts’ treatment of the *Unocal* proportionality test, there is strong evidence to support the claim that courts are really engaging in a context-specific, effects-based test similar to the Rule of Reason—one that is narrowly tailored to address the threats and defenses involved in the case at hand.

The evidence of an effects-based test is most apparent in cases where Delaware courts have found a defense proportional based on its ability to prevent a legitimate threat.<sup>136</sup> These opinions hold that if directors act in good faith by defending against a legitimate threat, a defensive tactic that defuses this threat will be proportional. The analysis in these opinions is rife with language endorsing an examination of a defense’s effects rather than a comparison of the severity of threat and response.<sup>137</sup>

In *Unocal* itself, the case that introduced the proportionality test and at least implicitly suggested the use of a standardized, multi-factor review, the Delaware Supreme Court’s analysis shied away from explicit reference to the factors it enumerated and instead focused on the effects of the defensive measure employed.<sup>138</sup> Rather than progressing through a series of factors, the court merely stated that *Unocal*’s defensive tactics sought to “defeat the inadequate Mesa offer,” and that “such efforts

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<sup>134</sup> See *Airgas*, 16 A.3d at 115 (endorsing the combination of a poison pill and a staggered board as nonpreclusive); *Versata Enters., Inc. v. Selectica, Inc.*, 5 A.3d 586, 601 (Del. 2010) (raising the rigor of preclusiveness review by adopting the “realistically unattainable” standard); *Yucaipa Am. Alliance Fund II v. Riggio*, 1 A.3d 310, 354 (Del. Ch. 2010) (finding a defense nonpreclusive because it did not impose a “herculean lift” on those waging proxy contests).

<sup>135</sup> See supra note 107 and accompanying text.

<sup>136</sup> See supra note 80.

<sup>137</sup> See supra note 80.

<sup>138</sup> *Unocal*, 493 A.2d at 956.

would have been thwarted by Mesa's participation in the exchange offer."<sup>139</sup> Essentially, because Unocal's defense promoted effects that the court found favorable to shareholders, the court deemed the measure reasonable.

In *Time*, a case employing the same style of proportionality review, the Delaware Supreme Court stated that:

The usefulness of *Unocal* as an analytical tool is precisely its flexibility in the face of a variety of fact scenarios. *Unocal* is not intended as an abstract standard; neither is it a structured and mechanistic procedure of appraisal . . . . The open-ended analysis mandated by *Unocal* is not intended to lead to a simple mathematical exercise . . . . To engage in such an exercise is a distortion of the *Unocal* process and, in particular, the application of the second part of *Unocal's* test . . . .<sup>140</sup>

The court then used this flexible, effects-based test to hold that Time's defensive measures were proportional, noting that they did not "'cram[] down' on [Time's] shareholders a management-sponsored alternative" or "preclude Paramount from making an offer for the combined Time-Warner company," but rather had the ultimate effect of protecting shareholders from the "legally cognizable threat" posed by "Paramount's eleventh hour offer."<sup>141</sup>

While more difficult to explain as an endorsement of an effects-based test, other Delaware cases that treat identification of a threat alone as enough to uphold a ruling of proportionality<sup>142</sup> still fit into this paradigm. While these opinions seemingly conflate the mere existence of a threat with satisfaction of proportionality review, they also make observations that the measures under review would likely frustrate the threat at hand.<sup>143</sup> Thus, while their direct discussion of proportionality may only address the fact that a threat existed, these opinions' accompanying acknowledgment of a defensive tactic's success, i.e., its effects, should be understood as an implicit part of their ruling.

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<sup>139</sup> *Id.*

<sup>140</sup> *Time*, 571 A.2d at 1153.

<sup>141</sup> *Id.* at 1153, 1155.

<sup>142</sup> See *supra* note 77.

<sup>143</sup> *Revlon*, 506 A.2d at 177 (holding that "the Note covenants [issued during the stock buy-back] stymied Pantry Pride's attempted takeover"); *Moran*, 500 A.2d at 1349 (stating that the poison pill at issue was "a preventive mechanism to ward off future advances").

Finally, the few recent cases that have conflated a finding of nonpreclusiveness with satisfaction of *Unocal* proportionality<sup>144</sup> can be explained in a similar manner. While these cases focus on preclusiveness during the discrete portion of the opinion discussing *Unocal* proportionality, they each contain statements elsewhere implying that their support for the defensive measure at issue is rooted in a fact-specific examination of that defense's effects and the conclusion that it would successfully defuse a threat to the corporation.<sup>145</sup>

*a. A Fact-Specific Inquiry*

A critical reason for the rise and continued vitality of the Rule of Reason is the importance of the context in which a given restraint arises. The intent of the parties, the relationship of the parties in the market (horizontal, vertical, or something in between), their relative shares of the market, barriers to entry, production processes, and many other details specific to a given restraint affect that restraint's ultimate propriety.<sup>146</sup>

In the same way, an analysis of a takeover defense's legality requires a highly detailed, ground-level examination of the communications between corporate directors and competitors, the financial condition of a corporation and its corresponding worth, the interlocking terms of highly complex tender offers and takeover defenses, the long-term plans of a

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<sup>144</sup> See supra note 82 and accompanying text.

<sup>145</sup> *Airgas*, 16 A.3d at 124 (noting that the Airgas board's continuing use of a poison pill was "preventing a change of control from occurring at an inadequate price"); *Yucaipa Am. Alliance Fund II v. Riggio*, 1 A.3d 310, 350 (Del. Ch. 2010) (holding that without Barnes and Noble's poison pill, the hostile bidder could amass "an effective control bloc that would allow it to [wield] great leverage . . . at the expense of other investors" and that by "cabin-ing" the hostile bidder with a poison pill, Barnes and Noble had "preserved [its] authority to protect the company's public stockholders").

<sup>146</sup> See *Chi. Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918) ("To determine [whether a restraint is anticompetitive] the court must ordinarily consider the facts peculiar to the business to which the restraint is applied; its condition before and after the restraint was imposed; the nature of the restraint and its effect, actual or probable. The history of the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences."); see also *Tom & Pak*, supra note 107, at 425 (listing a number of factors that could possibly be used in assessing the reasonableness of restraints and emphasizing that "courts may experiment" with different factors).

corporation's board, the composition of a corporation's existing shareholders—and the list continues.<sup>147</sup>

For this reason, it should come as no surprise that *Unocal* balancing, rather than proceeding via a standardized method involving a set of universally applicable factors, has assumed a guise similar to the Rule of Reason, developing as an ad hoc investigation of a defensive measure's true effects. Admittedly, employing a less tailored, more universal methodology to gauge proportionality would provide frequent players in the takeover game with prospective legal guidance. Without a set of constant factors with which to measure a threat and response's relative severity, directors may have little sense of where their actions fall on the *Unocal* proportionality spectrum and may lack the ability to make prospective predictions about the legality of their actions.<sup>148</sup>

Unfortunately, unlike other legal questions that easily lend themselves to standardized multi-factor tests,<sup>149</sup> courts and commentators have recognized that there is no one set of factors that can capture the positive and negative effects of all potential threats and defenses.<sup>150</sup> Even in *Unocal*'s listing of the factors to be explored, the court stated that these were merely “examples” of concerns to be considered, realizing the im-

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<sup>147</sup> See Craig W. Palm & Mark A. Kearney, A Primer on the Basics of Directors' Duties in Delaware: The Rules of the Game (Part II), 42 Vill. L. Rev. 1043, 1064 (1997) (“*Unocal*'s enhanced scrutiny is very fact specific.”); see also Sean J. Griffith, Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence, 55 Duke L.J. 1, 30 (2005) (“[T]he resolute fact specificity of Delaware jurisprudence has continually frustrated attempts to harden fiduciary standards into clear rules.”).

<sup>148</sup> See Ehud Kamar, Shareholder Litigation Under Indeterminate Corporate Law, 66 U. Chi. L. Rev. 887, 892 (1999) (noting that “[t]he primary cost of indeterminacy in corporate law is that it undermines the efficacy of the law in directing managerial behavior”); see also Tom & Pak, *supra* note 107, at 400 (discussing the relative costs of uncertainty and certainty in the antitrust context).

<sup>149</sup> See, e.g., 17 U.S.C. § 107 (2006) (codifying copyright law's fair use factors); 18 U.S.C. § 3553 (2006) (listing federal criminal sentencing factors); *Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 241 (1981) (outlining forum non conveniens factors); *Colo. River Water Cons. Dist. v. United States*, 424 U.S. 800, 814–16 (1976) (establishing federal court abstention doctrine factors); *Polaroid Corp. v. Polarad Elecs. Corp.*, 287 F.2d 492, 495 (2d Cir. 1961) (discussing the Second Circuit's version of trademark law's likelihood of confusion factors).

<sup>150</sup> See Kamar, *supra* note 148, at 891 (“Although court decisions list relevant criteria for judging managerial behavior, these criteria are not exhaustive. Indeed, courts often emphasize their incompleteness, leaving the legal community wondering what additional criteria may prove relevant in the future.”); see also Arthur, *supra* note 102, at 350 (stating in the antitrust context that “the issues raised by the new regulation, especially of mergers and vertical restraints, were too complex to be resolved effectively and consistently by bright-line rules and, considering the institutional limits of courts, perhaps by any legal standard” (footnote omitted)).



possibility of reducing the reasonableness inquiry to a discrete, rigidly fixed list of factors.<sup>151</sup>

Given the parallels between the highly complex transactions involved in both antitrust and takeover-defense suits, it seems altogether appropriate that the latter be resolved by an analytical framework specifically designed to address the intricacies of the former.<sup>152</sup> In applying *Unocal*, Delaware courts likely found the application of a standardized, factor-based test nearly impossible, and whether consciously or not, slipped into a Rule of Reason–like, effects-based analysis that, in the words of the Supreme Court, was “meet for the case.”<sup>153</sup>

*b. Workability*

Accepting that a standardized multi-factor test cannot be crafted broadly enough to cover the infinite number of threats and defenses that crop up in the hostile takeover setting, it becomes apparent that a meaningful comparison of threat and response is nearly impossible. A court cannot, in a predictable and generalized fashion, balance the threat posed with the defensive tactic adopted when no common metric exists to translate the severity of each into comparable units.

The workable alternative is an ad hoc balancing tailored to the facts of each case and focusing on the net effects that a given defense will have. Without a ruler to measure relative severity, an assessment of threat and defense’s proportionality cannot be achieved without attempting to predict how the two will interact. Thus, Delaware courts have had no choice but to examine the net effects they anticipate will result from a defense and to use this prediction to determine if the defense is reasonable in relation to the threat posed.<sup>154</sup>

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<sup>151</sup> *Unocal*, 493 A.2d at 955.

<sup>152</sup> See Allen, Jacobs & Strine, *supra* note 74, at 1069–70 (stating that “[g]iven the informational . . . constraints” and “the full ramifications of the policy choices the judges are being asked to make,” the tailored, “case-specific approach” adopted by Delaware courts is appropriate). But see Kahan & Kamar, *supra* note 74, at 1239 (arguing that “[t]he limited predictive value of Delaware corporate law precedents” refutes the claim that Delaware’s corporate law is “markedly better” than that of other states).

<sup>153</sup> See, e.g., *Unitrin*, 651 A.2d at 1373–74 (“The enhanced judicial scrutiny mandated by *Unocal* is not intended to lead to a structured, mechanistic, mathematical exercise. Conversely, it is not intended to be an abstract theory. The *Unocal* standard is a flexible paradigm that jurists can apply to the myriad of ‘fact scenarios’ that confront corporate boards.” (citations omitted)).

<sup>154</sup> See *supra* Subsection III.B.4.

That said, there is nothing inherently wrong with relying on a court's prediction of a defensive measure's effects to assess reasonableness. After all, even the alternative to the effects-based approach, i.e., a standardized, multi-factor test for measuring proportionality, may only be a tool for approximating the effects that given actions will have.<sup>155</sup> The factors employed in such tests are typically mere proxies for predicting the attendant outcomes when they are satisfied,<sup>156</sup> and these factors may not always serve as accurate forecasting tools.<sup>157</sup> While allowing courts with little business experience to abandon the use of such proxies and directly predict a given tactic's effects could be dangerous, Delaware courts' expertise in adjudicating corporate disputes<sup>158</sup> makes their use of an openly effects-based method, one that assesses reasonableness based on a court's educated view of how a threat and defense will interact, no more objectionable than the use of cumbersome, ill-fitted factors.<sup>159</sup>

*c. Delaware Courts' Substantive and Procedural Advantage*

Finally, Delaware courts, known for their expertise and rapid disposition of corporate cases, may actually be in a better position to engage in the sort of fact-specific, effects-based inquiry employed under a Rule of

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<sup>155</sup> See, e.g., Robert E. Pfeffer, Who's Fooling Whom: An Economic Analysis of Expressive Trademark Use, 6 Wake Forest Intell. Prop. L.J. 69, 100 (2006) (asserting that likelihood of confusion analysis is merely a means of "determining whether consumers will be misled about who produced the product").

<sup>156</sup> See Christopher A. Brown, Recent Developments in Intellectual Property Law, 42 Ind. L. Rev. 1071, 1075 (2009) (discussing the likelihood of confusion factors "as proxies for the likelihood of confusion"); Julie R. O'Sullivan, The Federal Sentencing Guidelines: Ten Years Later: In Defense of the U.S. Sentencing Guideline's Modified Real-Offense System, 91 Nw. U. L. Rev. 1342, 1366 n.102 (1997) (discussing certain sentencing factors as proxies for the danger posed by criminals).

<sup>157</sup> See Michael Grynberg, The Judicial Role in Trademark Law, 52 B.C. L. Rev. 1283, 1325-26 (2011) (criticizing overreliance on factor-based tests because "the adjudicative function is not served by false exercises in formalism" and because "[s]umming favored factors in order to reach legal conclusions of likelihood of confusion . . . independent of the consumer experience allows judges to engage in stealth lawmaking"); O'Sullivan, *supra* note 156, at 1366 n.102 (arguing that "drug and dollar amounts should not serve as a largely unqualified proxy for the danger that such crimes pose to the public or the victim").

<sup>158</sup> See *infra* note 160.

<sup>159</sup> See Bainbridge, *supra* note 10, at 800 (approving the tailored approach Delaware courts have taken towards *Unocal* proportionality and arguing that "by adopting a flexible standard rather than the prophylactic rules proposed by the academic critics of *Cheff*, Delaware struck a balance between authority and accountability").

Reason-like analysis than the typical federal court enforcing the anti-trust laws from which the Rule of Reason had its genesis.

To engage in an effects-based test in the context of takeover defenses, a court must be able to discern with some reliability the likely results of a given threat and defense's interaction. Because the legitimacy of a court's rulings will hinge largely on the accuracy with which it can predict these effects, Delaware's Court of the Chancery, known for its experience in corporate law, is clearly as well equipped as any court in the country to engage in an effects-based review of defensive measures.<sup>160</sup>

Furthermore, one of the most pronounced weaknesses of an effects-based test is the lack of guiding precedent and predictability it provides.<sup>161</sup> Even when the combination of a defense and threat in a given case is quite similar to one validated in earlier case law, the likelihood that the current situation is identical to its predecessor is extremely low, highlighting the uncertainty created by fact-driven rules.<sup>162</sup> At the most, these tailored rules give mere hints as to how a court would evaluate similar defenses.

This problem is greatly diminished in Delaware, however, given the speed with which Delaware courts dispatch corporate cases.<sup>163</sup> Because

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<sup>160</sup> See William H. Rehnquist, *The Prominence of the Delaware Court of Chancery in the State-Federal Joint Venture of Providing Justice*, 48 *Bus. Law.* 351, 354 (1992) ("Corporate lawyers across the United States have praised the expertise of the Court of Chancery, noting that since the turn of the century, it has handed down thousands of opinions interpreting virtually every provision of Delaware's corporate law statute. No other state court can make such a claim. . . . Judicial efficiency and expertise, a well-paid and well-respected judiciary, innovative judicial administration, courageous leadership—these hallmarks of the Delaware Court of Chancery provide a fine example of a somewhat specialized state court system in action."); Demetrios G. Kaouris, Note, *Is Delaware Still a Haven for Incorporation?*, 20 *Del. J. Corp. L.* 965, 975 (1995) ("Delaware's Court of Chancery has developed a national reputation of expertise in dealing with corporate law matters. . . . The chancery court's reputation for excellence also has enabled it to attract some of the most experienced lawyers to serve as chancellors and vice-chancellors.").

<sup>161</sup> See *supra* note 148 and accompanying text.

<sup>162</sup> See, e.g., *Time*, 571 A.2d at 1152–53 ("[T]he Court of Chancery has suggested that an all-cash, all-shares offer, falling within a range of values that a shareholder might reasonably prefer, cannot constitute a legally recognized 'threat' to shareholder interests sufficient to withstand a *Unocal* analysis. . . . From those decisions by our Court of Chancery . . . plaintiffs extrapolate a rule of law that an all-cash, all-shares offer with values reasonably in the range of acceptable price cannot pose any objective threat to a corporation or its shareholders. . . . Since Paramount's offer was all-cash, the only conceivable 'threat,' plaintiffs argue, was inadequate value. We disapprove of such a narrow and rigid construction of *Unocal* . . .").

<sup>163</sup> See William B. Chandler III & Anthony A. Rickey, *Manufacturing Mystery: A Response to Professors Carney and Shepherd's "The Mystery of Delaware Law's Continuing*

corporations are able to present their defenses to a Delaware court and obtain a rapid response as to their legality,<sup>164</sup> they do not face the sort of uncertainty that might otherwise pervade such a system of review. Corporations looking to test the validity of a new defense are able to take preliminary cues from rulings on similar defenses, attempt to push the envelope with a new defense, and receive an immediate response as to its permissibility.<sup>165</sup> This notable procedural advantage helps further explain how Delaware's use of a doctrine founded on extremely narrow precedent has nonetheless cemented the state as the premier forum for corporate litigation.

#### CONCLUSION

For decades, commentators have criticized the inconsistencies and lack of predictability surrounding Delaware courts' takeover-defense jurisprudence, demanding large-scale reform and the adoption of predictable bright-line rules.<sup>166</sup> This Note disputes the wisdom of such proposals, arguing that Delaware courts are actually applying a uniform and coherent methodology to evaluate takeover defenses, just a different sort than the language of *Unocal* and its progeny might initially lead one to expect. Contending that Delaware takeover-defense doctrine actually parallels federal antitrust law's Rule of Reason, this Note presents an original unifying theory of this allegedly fractured regime, offering a unique interpretation of takeover-defense jurisprudence that not only tolerates but also benefits from the law's alleged inconsistencies.

To begin, this Note argues that the requirement of good faith, as initially instituted by *Cheff*, is less about inquiring into the validity of the

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Success," 2009 U. Ill. L. Rev. 95, 128 ("Commentators frequently note both the flexibility and the speed of the Delaware courts in dealing with corporate cases."); Kaouris, *supra* note 160, at 975–76 ("The court of chancery has no jurisdiction over criminal or tort actions which often yield backlogs in the state and federal judicial systems. This allows the court of chancery to hear cases and render decisions quickly. . . . The [Delaware] supreme court is also able to deal with appeals in corporate cases very quickly." (footnotes omitted)).

<sup>164</sup> For example, the Delaware Supreme Court rendered an oral decision in *Time* only ten days after the Chancery Court issued its opinion on the matter. Leo Herzel & Laura D. Richman, Foreword to R. Franklin Balotti & Jesse A. Finkelstein, *The Delaware Law of Corporations and Business Organizations* F-6 n.24 (3d ed. 2011).

<sup>165</sup> See Kahan & Kamar, *supra* note 74, at 1240 (explaining that "[b]ecause [Delaware corporate] law is fact intensive, there are many potential factual disputes that need to be resolved through litigation," hence corporations' tendencies to test questionable defenses via fast-paced litigation).

<sup>166</sup> See *supra* notes 11, 74 and accompanying text.

threat to the corporation and, like antitrust law's preliminary requirement that defendants prove procompetitive effects, more about determining whether directors can provide any proshareholder rationale for their defensive actions. Delaware courts' oscillation in evaluating what constitutes a valid threat can be explained with the observation that courts are not trying to create a laundry list of threats that satisfy the good-faith requirement, but rather are evaluating the specific circumstances surrounding each threat to determine whether directors could plausibly argue that their actions had any proshareholder effects.

This Note further argues that Delaware courts' use of *Unitrin*'s preclusiveness review and *Revlon* duties to label certain actions as per se illegal is nearly identical to the antitrust strategy of prohibiting, without exception, certain restraints on trade. While the definition of preclusive and the trigger for *Revlon* duties have both resisted bright-line definition, the use of a standard rather than a rule when applying the per se label should not be deemed objectionable. In recent years, antitrust law itself, the progenitor of per se classifications, has greatly narrowed its use of the per se label and in many cases has undertaken substantial preliminary investigation simply to determine when such a label applies.

Finally, this Note posits that rather than applying *Unocal* review as a balancing test based on the relative severity of threat and response, Delaware courts are conducting an effects-based inquiry, attempting to predict the interaction of threat and defense. Under this argument, *Unocal* proportionality is not rooted in a set of standardized factors used to translate the units of threat and defense into comparable data points, but, like the Rule of Reason, is more interested in determining the ultimate outcome that a defense will have on those the law is meant to protect—in Delaware's case, shareholders. Furthermore, Delaware courts, relying on their unsurpassed business expertise and procedural alacrity, are arguably even more well suited to this sort of Rule of Reason-like analysis than the federal courts applying the original Rule of Reason.

Ultimately, this Note demonstrates that Delaware's takeover-defense jurisprudence is not the capricious and disjointed regime that many commentators suggest. Rather, this area of the law employs an admittedly fact-specific method of review, but one that operates within a uniform and predictable framework. When coupled with the Delaware courts' rapid decision making and formidable experience with the corporate form, this tailored approach to evaluating takeover defenses sheds many of its faults while retaining the advantage of flexibility, providing a level

of personalized review much more likely to serve logic and reason than any exercise in predictable formalism ever could.