

PURE RESOURCES: THE LATEST WORD FROM THE DELAWARE COURTS ON THE STANDARD OF REVIEW APPLICABLE TO A TENDER OFFER BY A CONTROLLING STOCKHOLDER

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I. INTRODUCTION.

The issue regarding the appropriate standard of judicial review to apply to a tender offer by a controlling stockholder for the minority shares in a Delaware corporation that it does not already own came to a head again recently in In Re Pure Resources, Inc. Shareholders Litig., C.A. No. 19876, Strine, V.C. (Del. Ch. Oct. 1, 2002; rev. Oct. 7, 2002). After a lengthy review of the doctrinal tension regarding the two strands of Delaware cases dealing with the appropriate standard of equitable conduct to be applied when a controlling stockholder seeks to acquire the rest of a Delaware corporation's shares that it does not already own, Vice Chancellor Leo Strine followed existing precedent and concluded that the entire fairness standard of review did *not* apply to a non-coercive tender offer by a majority stockholder.

II. THE FACTS IN *PURE RESOURCES*.

Unocal Corporation held 65.4% of Pure Resources, Inc. ("Pure"). Pure was the result of a spin-off in May 2000 of Unocal's Permian Basin unit and a combination of that unit with Titan Exploration, Inc. Pure Resources, slip op. at 3. The remaining 34.6% of Pure was held by Titan's former stockholders, including management who stayed on to run Pure. Id. The

¹ The views expressed herein are not presented as those of the firm, Morris, Nichols, Arsht & Tunnell, or its clients.

largest minority stockholder of Pure was its Chairman and CEO, Jack Hightower, who owned 6.1% of the outstanding stock. Id.

There were several important agreements entered into when Pure was formed. A Stockholders Voting Agreement required Unocal and Hightower to elect to the Pure board of directors five persons designated by Unocal (so long as Unocal owned greater than 50% of Pure's common stock), two persons designated by Hightower and one person jointly selected by Unocal and Hightower. Id. at 4. A Business Opportunities Agreement ("BOA") limited Pure to the oil and gas production business in certain designated geographic areas, essentially consistent with the areas covered by Titan prior to the combination, for so long as Unocal owned at least 35% of Pure. Id. at 5. The BOA also included an acknowledgement by Pure that it had no business expectancy in opportunities outside its area and also expressly permitted Unocal to compete with Pure in its areas of operations. Id. at 5-6. A Non-Dilution Agreement provided Unocal with a preemptive right to maintain its proportionate ownership in the event that Pure issued new shares. Id. at 6. Finally, members of Pure's management team entered into Put Agreements with Unocal allowing them to put their Pure stock to Unocal upon the occurrence of certain triggering events, such as a tender offer by Unocal. Id.

The BOA, however, did not guarantee that the two Unocal officers who sat on the Pure board, Ling and Chessum, would be protected from liability if Unocal actually sought to pursue an opportunity in Pure's area of operations, and Unocal owed a separate indemnification obligation to them. Id. at 8. As a result, Unocal analyzed the possibility of acquiring the rest of Pure in the summer of 2001, but the events of September of that year caused Unocal to postpone any proposal, and it informed Pure's board that all evaluation work had stopped. Id. at 9. However, Unocal soon renewed consideration of the transaction and, while

Ling knew of this renewed interest, he did not inform the rest of Pure's board of directors. Id. at 10. At the same time, Pure's board was considering a financing vehicle, a Royalty Trust, to monetize the value of certain mineral rights owned by Pure, which put pressure on Unocal to decide whether to proceed with the acquisition of Pure. Id. at 10-12.

On August 20, 2002, Unocal made a "surprise" exchange offer for Pure stock at an exchange ratio of .6527 shares of Unocal per share of Pure, contingent upon obtaining 90% of the outstanding shares of Pure. Id. at 12-14. Because of significant ties to Unocal and because the Put Agreements could have materially affected the decisions of the Hightower designees, only two members of Pure's board were nominated to the special committee of directors formed to consider the exchange offer. Id. at 14-15. The committee hired independent counsel and two financial advisors, Credit Suisse First Boston ("CSFB") and Petrie Parkman & Co. ("Petrie Parkman"), for the purpose of evaluating the offer. Id. at 15-16. The key features of Unocal's formal offer included the .6527 exchange ratio, a waivable 90% condition, a non-waivable majority of the minority tender provision, and a statement by Unocal that it intended to complete a short-form merger upon completion of the tender offer at the same exchange ratio. Id. at 16-17.

The special committee sought to clarify the authority delegated to it with respect to the offer. Specifically, the committee sought to have delegated to it the full authority of the board of directors to respond to the offer, including power to seek alternative transactions, and to institute a shareholder rights plan (*i.e.*, a "poison pill"). Id. at 17. Chessum and Ling engaged Unocal counsel to help limit the power of the special committee, and "the bold resolution drafted by the Special Committee counsel was whittled down to take out any ability on the part of the

Special Committee to do anything other than study the Offer, negotiate it, and make a recommendation on behalf of Pure in the required 14D-9.” Id. at 17-18.

The Court was critical of the committee’s excuses for its failure to push for the power to institute a poison pill (*e.g.*, the Non-Dilution Agreement prevented the pill from being deployed and the committee’s power to make a negative recommendation in light of already existing opposition was sufficient protection), stating that its “ability to have confidence in these justifications has been compromised by the Special Committee’s odd decision to invoke the attorney-client privilege as to its discussion of these issues.” Id. at 19. The Court went out of its way in a footnote to criticize this litigation decision and cautioned practitioners in this area, stating that in other cases, the Court has “explicitly drawn negative inferences when a board has shielded its actions from view”:

[I]n general it seems unwise for a special committee to hide behind the privilege, except when the disclosure of attorney-client discussions would reveal litigation-specific advice or compromise the special committee’s bargaining power. In other than those circumstances, the very nature of the special committee process as an integrity-ensuring device requires judicial access to communications with advisors, especially when such committees rely so heavily on these advisors to negotiate and provide expertise in the absence of the unconflicted assistance of management.

Id. at 19 n.8 (citations omitted).

After the special committee’s authority was determined, the committee met on a regular basis, attempted to get Unocal to increase its offer and then prepared a 14D-9 on behalf of Pure recommending that shareholders not tender into the offer. Id. at 20.

III. THE PARTIES’ POSITIONS AND THE COURT’S ANALYSIS OF THE CONTROLLING LAW.

The majority of the public stockholders and lead plaintiffs in Pure Resources were institutional investors. Plaintiffs argued that the exchange offer should be enjoined because (i)

the offer was subject to entire fairness and the record supported a conclusion that the transaction could not survive a fairness review, (ii) the offer was actionably coercive, and (iii) the disclosures provided to the stockholders were materially incomplete and misleading. Id. at 21-22. Specifically, plaintiffs argued that the structural power of Unocal over Pure and its board, as well as Unocal's involvement in determining the scope of the special committee's authority, made the offer other than a voluntary, non-coercive transaction. Id. at 22. In support of their argument, plaintiffs relied on the Delaware Supreme Court's decision in Kahn v. Lynch Communication Systems, Inc., 638 A.2d 1110 (Del. 1994), which held that the entire fairness standard of review applied to any interested merger involving a controlling stockholder, even if the merger is negotiated by an independent committee of directors and is subject to a majority of the minority vote condition. Id. at 22-23.

In response, relying upon Solomon v. Pathe Communications Corp., 672 A.2d 35 (Del. 1996), Unocal argued that the rule in Kahn was not applicable since Unocal proceeded by way of an exchange offer, not a negotiated merger. Id. at 24. Unocal asserted that it was free to make an exchange offer at whatever price it determined so long as it did not: (i) "structurally coerce" the Pure minority by suggesting explicitly or implicitly that injurious events would occur to those stockholders who opted not to tender; or (ii) mislead the Pure minority into tendering by concealing or misstating the material facts. Id.

Vice Chancellor Strine then embarked upon a lengthy discussion of the two lines of authority relied upon by the parties, focusing on the "doctrinal tension" between the two strands of authority. Id. at 25.

A. Controlling Stockholder Mergers – Subject To Entire Fairness Review.

The first strand of cases discussed by Vice Chancellor Strine in Pure Resources deals with situations in which a controlling stockholder negotiates a merger agreement with a target board of directors to buy out the minority stockholders. Pure, slip op. at 28. Generally speaking, that line of “decisional law emphasizes the protection of minority stockholders against unfairness.” Id. at 29. In other words, the acquisition by a majority stockholder of the minority shares that it does not own in a Delaware corporation *by way of a negotiated merger* pursuant to 8 Del. C. § 251 is subject to the entire fairness standard of review. See, e.g., Kahn v. Lynch Communication Systems, Inc., 638 A.2d 1110 (Del. 1994). When the exacting entire fairness test applies, a transaction must be fair as to both price and process. Weinberger v. UOP, Inc., Del. Supr., 457 A.2d 701 (1983) (holding “fair dealing” embraces questions of process, particularly how transaction was timed, initiated, structured, negotiated, and disclosed, and how approvals of directors and stockholders were obtained, and that “fair price” relates to the economic and financial terms of the transaction).

In Kahn v. Lynch, the Delaware Supreme Court held that “[i]t is a now well-established principle of Delaware corporate law that in an interested merger, the controlling or dominating shareholder proponent of the transaction bears the burden of proving its entire fairness.” 638 A.2d at 1117. The Supreme Court in Kahn concluded that entire fairness is the appropriate standard of review, even when certain protective devices are utilized, such as (i) the negotiation of the merger by a well-functioning independent committee of the target’s directors with the power to veto the merger or (ii) a majority of the minority stockholder vote. The Court in Kahn noted, however, that the “approval of the transaction by an independent committee of directors or an informed majority of minority shareholders shifts the burden of proof on the issue

of fairness from the controlling or dominating shareholder to the challenging shareholder-plaintiff.” Id.

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From a policy perspective, the Supreme Court in Kahn held that the entire fairness standard remained the appropriate standard of review, notwithstanding the presence of protective devices, because of the “inherent coercion” that exists when a controlling stockholder seeks to acquire the minority’s shares. As explained by Vice Chancellor Strine in Pure, in “colloquial terms, the Supreme Court [in Kahn] saw the controlling stockholder as the 800-pound gorilla whose urgent hunger for the rest of the bananas is likely to frighten less powerful primates like putatively independent directors who might well have been hand-picked by the gorilla (and who at the very least owed their seats on the board to his support).” Slip op. at 30. Another form of “inherent coercion” recognized by the Supreme Court in Kahn is that “shareholders voting on a parent subsidiary merger might perceive that their disapproval could risk retaliation of some kind by the controlling stockholder,” such as the cessation of dividend payments or a subsequent cash out merger at a less favorable price. Kahn, 638 A.2d at 1116. Finally, as noted by the Court in Pure, another policy choice recognized in the Kahn line of cases is that the statutory appraisal remedy is “less than fully adequate protection for stockholders facing Inherent Coercion from a proposed squeeze-out merger.” Pure, slip op. at 31 n.20.

B. Controlling Stockholder Tender Offers Followed By Short-Form Mergers – Not Subject To Entire Fairness Review.

The second strand of cases discussed by Vice Chancellor Strine in Pure Resources involves tender offers by controlling stockholders conditioned on acquiring enough tenders for it to obtain 90% of the subsidiary’s shares, thereby enabling the controlling stockholder to

consummate a short-form merger pursuant to 8 Del. C. § 253. As explained by Vice Chancellor Strine in Pure, as “a matter of statutory law, this way of proceeding is different from the negotiated merger approach in an important way: neither the tender offer nor the short-form merger requires any action by the subsidiary’s board of directors.” Pure, slip op. at 33. Tender offers, unlike mergers, are not addressed by the Delaware General Corporation Law, and take place “between the controlling shareholder and the minority shareholders so long as the offering conditions are met.” Id. Similarly, under 8 Del. C. § 253, the short-form merger can be effected by the controlling stockholder itself, without the need for board approval.²

1. ***Solomon v. Pathe Communications Corp.***

As noted by Vice Chancellor Strine, one of the leading Delaware cases in this strand is Solomon v. Pathe Communications Corp., 672 A.2d 38 (Del. 1996). In Solomon, the Delaware Supreme Court affirmed the dismissal of a complaint challenging a tender offer, holding:

In the case of totally voluntary tender offers, as here, courts do not impose any right of the shareholders to receive a particular price. . . . Delaware law recognizes that, as to allegedly voluntary tender offers (in contrast to cash-out mergers), the determinative factor as to voluntariness is whether coercion is present, or whether there is ‘materially false or misleading disclosures made to shareholders in connection with the offer.’ . . . [I]n the absence of

² As noted by Vice Chancellor Strine in Pure, for many years, the option of consummating a short-form merger under Section 253 at the conclusion of a tender offer “was of uncertain utility . . . because it was unclear whether §253 mergers were subject to an equitable requirement of fair process at the subsidiary board level.” Slip op. at 33. That uncertainty, however, was resolved in Glassman v. Unocal Exploration Corp., 777 A.2d 242 (Del. 2001). In Glassman, the Delaware Supreme Court held that, “absent fraud or illegality, appraisal is the exclusive remedy available to a minority stockholder who objects to a short-form merger.” 777 A.2d at 248. In so holding, the Supreme Court noted that, “[a]lthough fiduciaries are not required to establish entire fairness in a short-form merger, the duty of full disclosure remains, in the context of this request for stockholder action.” Id.

coercion or disclosure violations, the adequacy of the price in a voluntary tender offer cannot be an issue.

Solomon, 672 A.2d at 39-40 (citations omitted).

2. The Aquila & Siliconix Cases.

Vice Chancellor Strine also noted two recent opinions from the Delaware Court of Chancery which followed Solomon's articulation of the standards applicable to a tender offer. For example, in In re Aquila, Inc. Shareholders Litig., 805 A.2d 184 (Del. Ch. 2002), a majority stockholder (UtiliCorp) made a non-coercive exchange offer conditioned upon the tender of a majority of the minority Aquila shares, and also committed to effect a short-form merger on the same terms as the exchange offer if the offer was successful. 805 A.2d at 188. Faced with these facts, Vice Chancellor Stephen Lamb denied the shareholder-plaintiffs' motion to enjoin the exchange offer, holding, based upon Solomon, that "Delaware law does not impose a duty of entire fairness on controlling stockholders making a non-coercive tender or exchange offer to acquire shares directly from the minority holders."³ Id. at 190.

Similarly, in In re Siliconix Inc. Shareholders Litig., C.A. No. 18700, Noble, V.C. (Del. Ch. June 19, 2001), minority stockholders of Siliconix sought to enjoin an exchange offer by Vishay Intertechnology for the minority shares in Siliconix that Vishay did not already own. The exchange offer contained a non-waivable majority of the minority provision and an

³ Because there were no independent directors on the Aquila board, plaintiffs claimed that the Aquila directors breached their fiduciary duties by failing to appoint two independent directors to consider the exchange offer. Vice Chancellor Lamb rejected this argument, holding that the "Aquila directors had no identifiable duty to appoint anyone to the board of directors, notwithstanding a provision in the NYSE Listed Company Manual, which provided that Aquila should have named two independent directors to an audit committee within three months of the completion of its IPO. 805 A.2d at 191 & n. 11. In addition, significantly, plaintiffs in Aquila made no claim that the disclosure materials circulated by UtiliCorp in connection with the exchange offer were, in any way, misleading. 805 A.2d at 190-91.

equivocal statement by Vishay that it intended to effect a short-form merger following a successful exchange offer, but noting that it was not required to do so and that there might be circumstances under which it would not do so. Siliconix, slip op. at 11-12. Vice Chancellor John Noble, again relying upon Solomon,⁴ held that “Vishay was under no duty to offer any particular price, or a ‘fair’ price, to the minority shareholders of Siliconix unless actual coercion or disclosure violations are shown.” Id. at 17. The Court specifically rejected plaintiffs’ disclosure and coercion claims (id. at 26-47) and, accordingly, denied plaintiffs’ request for a preliminary injunction.

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Vice Chancellor Strine explained in Pure that the focus of the policy underlying the Solomon line of cases “is on the right of willing buyers and sellers of stock to deal with each other freely, with only such judicial intervention as is necessary to ensure fair disclosure and to prevent structural coercion.” Pure, slip op. at 48. The advantage of such an approach is that “it provides a relatively non-litigious way to effect going private transactions and relies upon minority stockholder to protect themselves.” Id. The cost of this approach, however, is that it may expose minority stockholders to the more subtle form of coercion that Kahn addresses, leaves them without adequate redress for unfairly timed and priced offers, and “minimizes the potential for the minority to get the best price, by arguably giving them only enough protection

⁴ The Court in Siliconix also relied upon In re Ocean Drilling & Exploration Co. Shareholders Litig., Consol. C.A. No. 11898, Chandler, C. (Del. Ch. Apr. 30, 1991), where the Court held that, “as a general principle, our law holds that a controlling shareholder extending an offer for minority-held shares in the controlled corporation is under no obligation, absent evidence that material information about the offer has been withheld or misrepresented or that the offer is coercive in some significant way, to offer any particular price for the minority-held stock.” Slip op. at 6-7.

to keep them from being structurally coerced into accepting grossly insufficient bids, but not necessarily merely inadequate ones.” Id.

IV. THE *PURE* COURT’S ATTEMPT TO HARMONIZE THE ARGUABLE INCONSISTENCY BETWEEN THE TWO STRANDS OF CASES.

After a lengthy discussion of the distinctions between negotiated mergers, in which the entire fairness standard applies, and non-coercive tender offers, where the entire fairness standard does not apply, the Court stated that it was “less than satisfied that there is a justifiable basis for the distinction between the *Lynch* and *Solomon* lines of cases.” Slip op. at 47. The Court noted that the inherent coercion believed to exist in the former, such that protective devices could not be effective in protecting minority shareholders, was equally likely to occur in a tender offer. Notwithstanding the discrepancies the Court found in the two lines of cases, the Court that it should not expand “the *Lynch* standard to controlling stockholder tender offers.” Slip op. at 50. Rather, the Court held that “the preferable policy choice is to continue to adhere to the more flexible and less constraining *Solomon* approach, while giving some greater recognition to the inherent coercion and structural bias concerns that motivate the *Lynch* line of cases.” Id.

The Court further stated that “[t]o the extent [its] decision to adhere to *Solomon* causes some discordance between the treatment of similar transactions to persist, that lack of harmony is better addressed in the *Lynch* line, by affording greater liability-immunizing effect to protective devices such as majority of minority approval conditions and special committee negotiation and approval.” Id. at 50-51. Significantly, Vice Chancellor Strine specifically suggested in a footnote that the use of protective devices in a negotiated merger might be sufficient to justify application of the business judgment rule:

A slight easing of the *Lynch* rule would help level the litigation risks posed by the different acquisition methods, and thereby provide an incentive to use the negotiated merger route. At the very least, this tailoring could include providing business judgment protection to mergers negotiated by a special committee and subject to majority of the minority protection. This dual method of protection would replicate the third-party merger process under 8 *Del. C.* § 251.

Id. at 51 n.43 (emphasis added).

Notwithstanding the Pure Court’s decision to apply the Solomon line of authority to the exchange offer at issue, the Court emphasized that “the *Solomon* line of cases does not eliminate the fiduciary duties of controlling stockholders or target boards in connection with tender offers made by controlling stockholders,” rather, that “question is the contextual extent and nature of those duties.” Id. at 51. In order to address the potential for coercion and unfairness posed by controlling stockholder tender/exchange offers (*i.e.*, what the Court termed the “prisoner’s dilemma”), the Court held that “our law should consider an acquisition tender offer by a controlling stockholder non-coercive only when”:

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

Id. at 51-52. These protections, the Court reasoned, “minimize the distorting influence of the tendering process on voluntary choice” and “recognize the adverse conditions that confront stockholders who find themselves owning what have become very thinly traded shares.” Id. at 52.

The Pure Court also held that the informational and timing advantages possessed by the controlling stockholder also require some countervailing protection if the minority is to

truly be afforded the opportunity to make an informed, voluntary tender decision. Id. at 52. In this regard, the Court held that the majority stockholder owes a duty to permit the independent directors on the target board:

- both free rein and adequate time to react to the tender offer, by (at the very least) hiring their own advisors and providing the minority with a recommendation as to the advisability of the offer; and
- to disclose adequate information for the minority to make an informed judgment.

Id. at 52-53. In addition, the Court also held that the controlling stockholder has a duty of fair disclosure and a duty to avoid misleading the independent directors and the minority stockholders. Id. at 53 n.47.

Importantly, Vice Chancellor Strine further noted in Pure that, when a controlling stockholder makes a tender offer that is not coercive in the manner described above, there is no duty on the part of the controlling stockholder “to permit the target board to block the bid through the use of the pill.” Slip op. at 54. Similarly, despite being critical of the Pure special committee’s decision not to push for the power to adopt a poison pill, the Court ultimately held that there is no duty “on the part of the independent directors to seek blocking power.” Id.

V. THE COURT PRELIMINARILY ENJOINS UNOCAL’S EXCHANGE OFFER.

After waxing eloquently regarding the appropriate standards to be applied by a Delaware court reviewing a tender offer by a controlling stockholder in general terms, Vice Chancellor Strine honed in on Unocal’s exchange offer and found it deficient in several respects.

A. Coercion.

The Pure Court first found that Unocal’s exchange offer, in its then present form, was “coercive because it include[d] within the definition of the ‘minority’ those stockholders

who are affiliated with Unocal as directors and officers,” and also included “the management of Pure, whose incentives [were] skewed by their employment, their severance agreements, and their Put Agreements.” Slip op. at 55. Vice Chancellor Strine reasoned that “[r]equiring the minority to be defined exclusive of stockholders whose independence from the controlling stockholder is compromised is the better legal rule (and result).” Id. Significantly, however the Court noted that this problem could be cured “if Unocal amends the Offer to condition it on approval of a majority of Pure’s unaffiliated stockholders.” Id.

Notwithstanding the glitch in the majority of the minority condition, the Court found that Unocal’s offer otherwise satisfied the requirements of “non-coerciveness” – *i.e.*, Unocal’s promise to consummate a §253 short-form merger promptly at the same price was “sufficiently specific,” and Unocal made no retributive threats. Id. at 56. In addition, the Court found that plaintiffs had failed to establish a likelihood of success on their claim that the Pure board should have blocked the offer with a poison pill or other measures. Despite the Court’s criticism of the special committee’s decision to invoke the attorney-client privilege to cloak its deliberations, the Court found that there was a rational basis to believe that a pill was not necessary to protect Pure’s minority against coercion, largely, because Pure’s management had expressed adamant opposition to the offer. Id. In addition, the Pure board allowed the special committee to recommend against the offer (as it did), to negotiate for a higher price (as it attempted to do), and to prepare Pure’s 14D-9 (as it did). Id.

Thus, other than the flaw in the majority of the minority condition, the Court held that plaintiffs did not have a likelihood of success on their attack on the merits of the offer.

B. Disclosure.

The Court next considered the plaintiffs' claims that neither the S-4 issued by Unocal in support of its offer nor the 14D-9 filed by Pure in response to the offer contained materially complete and accurate disclosures. Before considering the merits of plaintiffs' claims, Vice Chancellor Strine recited the well-established principles of Delaware law relating to disclosure, including the following:

- the S-4 and 14D-9 must contain information that a "reasonable investor would consider important in tendering his stock," including information necessary to make a reasoned decision whether to seek appraisal in the event Unocal effects a prompt short-form merger;
- in order for undisclosed information to be material, there must be a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable stockholder as having significantly altered the 'total mix' of information made available"; and
- the S-4 and 14D-9 are required "to provide a balanced, truthful account of all matters" they disclose and must avoid misleading partial disclosures (*i.e.*, when a disclosure document ventures into certain subjects, it must do so in a manner that is materially complete and unbiased by the omission of material facts).

Slip op. at 58-59 (citations omitted).

1. Disclosure Of Investment Banker Valuation Analyses.

Plaintiffs' first disclosure claim was that the 14D-9 failed to disclose *any* substantive portions of the work of CSFB and Petrie Parkman, the financial advisors to the special committee, "even though the bankers' negative views of the Offer [were] cited as a basis for the board's own recommendation not to tender." *Id.* at 59. Plaintiffs argued that the Pure board owed the minority a duty to provide them with material information about the value of Pure's shares, including the underlying analysis of value developed by the special committee's

advisors, particularly since the Pure minority stockholders were subject to an immediate short-form merger if the offer succeeded and would have to make a decision whether to seek appraisal.

Id.

In response, the Pure director defendants argued that the 14D-9 contained a great deal of financial information, including the actual opinions of the financial advisors, and that the S-4 also contained historical financial information about Pure's results as well as certain projections of future results. Id. at 60. The special committee further argued that disclosure of its advisors' views on the value of Pure could hurt their bargaining leverage and be injurious to the minority since the committee still hoped to secure a better price in negotiations. Id.

The Court noted that there has been "an ongoing debate in Delaware corporate law" regarding whether disclosure of investment bankers' valuation analyses are required – an issue the Court concluded "has often been answered in an intellectually unsatisfying manner." Id. at 59-60. The Court conceded that "Delaware courts have been reluctant to require informative, succinct disclosure of investment banker analysis in circumstances in which the bankers' views about value have been cited as justifying the recommendation of the board," purportedly due to a fear of "stepping on the SEC's toes" and "encouraging prolix disclosures." Id. at 59.

The Court resolved what it deemed to be an "ambivalence" in the Delaware cases regarding disclosure of investment bankers' valuation analyses "in favor of a firm statement that stockholders are entitled to a fair summary of the substantive work performed by the investment bankers upon whose advice the recommendations of their board as to how to vote on a merger or tender rely." Id. at 61-62. The Court reasoned that, "[l]ike a court would in making an after-the-fact fairness determination, a Pure minority stockholder engaging in the before-the-fact decision

whether to tender would find it material to know the basic valuation exercises that [CSFB] and Petrie Parkman undertook, the key assumptions that they used in performing them, and the range of values that were thereby generated.” Id. at 62-63.

The Court rejected the contention that such disclosures might improvidently reveal the special committee’s “reserve price” in this circumstance since the Pure board had not taken steps to stop the offer and, instead, left it up to the stockholders whether to “say no.” Id. at 63. Finally, the Court noted one other policy reason for its decision: “when controlling stockholders make tender offers, they have large informational advantages which can only be imperfectly overcome by the special committee process, which almost invariably involves directors who are not involved in the day-to-day management of the subsidiary.” Id. at 64. Thus, the Court concluded that plaintiffs had shown a reasonable probability of success on their claim that the 14D-9 omitted material information regarding the investment bankers’ valuation analyses.

**2. Disclosure Regarding The Pure Board’s
Rejection Of The Special Committee’s Request
For Broader Authority.**

Plaintiffs next claimed that the 14D-9 was deficient because it contained an inaccurate and materially misleading summary of the Pure board’s rejection of the special committee’s request for broader authority. In that regard, the 14D-9 contained only two sentences regarding this topic, stating only that the Pure board met to discuss the special committee’s request for a clarification of its purposes, powers, authority and independence, and that, after discussion, the Pure board adopted clarifying resolutions.

The Pure Court found, without hesitation, that this disclosure was inaccurate and materially misleading. Slip op. at 65. The Court reasoned as follows:

- no reasonable reader would know that the special committee sought to have the full power of the Pure board delegated to it – including the power to block the offer with a poison pill – and had been rebuffed; and
- no reasonable reader would know that Chessum and Ling (who supposedly had recused themselves from the Pure board’s response to the offer) had reinstated themselves into the process with Unocal’s legal advisors and “had beaten back this fit of assertiveness by the Special Committee.”

Id. at 65. The Court further held that Pure stockholders would find it material to know that the special committee had been denied power it sought. Id. Moreover, the Court concluded that the minority stockholders were entitled to “a balanced and truthful recitation of events, not a sanitized version that is materially misleading.” Id. at 66. **Disclosure Of Unocal’s Reserve Price.**

Plaintiffs next claimed that Unocal’s disclosure that the Unocal board authorized the offer at the specific exchange ratio ultimately used in the offer was materially misleading because the Unocal board actually gave its management the authority to make an offer at a greater exchange ratio than was offered. Slip op. at 66. Plaintiffs also asserted that the specific figure authorized by the Unocal board should have been disclosed to the Pure board by Ling, since he heard it and still reinjected himself into the negotiations regarding the special committee’s powers. Id.

The Pure Court disagreed, holding that a controlling stockholder had no duty to disclose its reserve price in these circumstances. Id. The Court reasoned that Delaware law “contemplates the possibility of a price negotiation in negotiated mergers involving a controlling stockholder, a practical impossibility if the reserve price of the controlling stockholder must be revealed.” Id. at 66-67. The Court also rejected plaintiffs’ contention that Ling had a duty to expose everything he knew about Unocal’s negotiating posture. Id. at 67. Significant to the

Court's conclusion on this issue was the absence of any persuasive evidence that the special committee was denied any material information from Pure that was available to Unocal; Unocal's own subjective reserve price was not such information. Id.

3. Disclosures Regarding "Key Factors" Motivating Unocal's Offer.

Finally, the Pure Court found Unocal's S-4 to be materially incomplete and misleading in two respects. First, while the S-4 contained an extensive section on conflicts of interest, it failed to disclose "a very real motivating factor for Unocal's offer – to eliminate the potential exposure to liability Chessum and Ling faced if Unocal began to compete with Pure in Pure's core areas of operation." Slip op. at 68. Second, although Unocal's board considered in its deliberations a management presentation indicating that Pure was considering "alternative funding vehicles not optimum to Unocal" (*i.e.*, apparently a reference to the Royalty Trust), Unocal omitted this motivation from the S-4. Id. The Court found that this subject was material because the Royalty Trust was "an important transaction that could be highly consequential to Pure's future if the Offer [did] not succeed," and was necessary to make the rest of the disclosures regarding Unocal's motives not misleading. Id. at 68-69.

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Based upon the possibility that structural coercion might taint the tendering process and the material disclosure deficiencies found, the Court issued a preliminary injunction against consummation of the exchange offer. On October 3, 2002, the Court issued a formal order enjoining the exchange offer until the majority of the minority condition was restructured and until certain additional or revised disclosures were made.

VI. SUBSEQUENT EVENTS.

On October 2, 2002, just after Vice Chancellor Strine's opinion, Unocal announced that it was amending its offer to increase the exchange ratio to 0.70, in part, at least, because Pure's stockholders had not tendered many shares at the original offering price. Unocal expressed a willingness to increase the exchange ratio to 0.74 if Pure management surrendered, for no consideration, certain existing rights under the Put Agreements. On October 3, 2002, Unocal formally amended its offer to increase the exchange ratio to 0.70. The amendment also (i) contained the additional disclosures required by the Court's preliminary injunction opinion, (ii) modified the majority of the minority condition as required by the Court's preliminary injunction opinion, and (iii) extended the expiration date to October 17, 2002. On October 9, 2002, Pure amended its 14D-9 to make additional disclosures required by the preliminary injunction opinion.

On October 9, 2002, Unocal announced that it (i) entered into agreements whereby Pure senior management would surrender their rights under the Put Agreements, (ii) was increasing the exchange ratio to 0.74, (iii) would extend the expiration of the offer until ten days after the formal amendment to the offer, and (iv) agreed to make the 90% condition non-waivable. Unocal also announced that it had been informed that the Pure special committee supported the revised offer. Unocal formally amended its offer on October 11, 2002 in accordance with its prior announcements. On October 15, 2002, Pure filed its 14D-9 recommending that stockholders tender their shares.

While Unocal was busy revising its offer, the Pure plaintiffs sought an interlocutory appeal, despite having obtained an injunction against the initial offer. Plaintiffs filed their application for an interlocutory appeal in the Court of Chancery, which was the required first step under Delaware Supreme Court Rule 42 relating to interlocutory appeals.

Specifically, plaintiffs sought to have two main issues certified for an interlocutory appeal to the Delaware Supreme Court: (1) whether the entire fairness standard should apply to Unocal's offer; and (2) whether Unocal and Pure's directors breached their fiduciary duties by failing to empower the special committee to, among other things, adopt a poison pill to block the offer. Unocal, wanting certainty regarding its offer, supported the application. The special committee took no position, and the other Pure directors provided a lengthy explanation why certification might not make sense, but did not actively oppose certification.

After reviewing the various factors set forth in Supreme Court Rule 42 regarding interlocutory appeals, the Vice Chancellor Strine denied certification, finding that the state of the record undercut the utility of an immediate appeal. In re Pure Resources, Inc. Shareholders Litig., C.A. No. 19876, Strine, V.C., slip op. at 8 (Del. Ch. Oct. 9, 2002). The Court specifically noted the fact that Unocal had increased its offer since the injunction was entered and that the special committee supported the revised bid, and stated that "the facts (about process and price) have proceeded in a manner that the evidentiary record has not caught up to." Id. The Court concluded that the significant issues decided in its preliminary injunction opinion could be settled by the Supreme Court "more reliably and less burdensomely later," either (i) after a ruling on summary judgment, or (ii) after an expedited trial. Id. at 9. The Court reasoned that such an alternative course "would ensure that the Supreme Court has adequate time to examine the issues raised on a settled and complete record, rather than on the basis of an incomplete record addressing an exchange offer that has now been increased substantially." Id.

Thereafter, the Delaware Supreme Court also denied certification of plaintiffs' request for an interlocutory appeal in a summary order. In re Pure Resources, Inc. Shareholders Litig., No. 557, 2002 (Del. Oct. 10, 2002) (Order denying interlocutory appeal). Subsequently,

plaintiffs filed an amended complaint alleging additional disclosure claims, and moved for a preliminary injunction against the revised offer. A hearing was scheduled for October 25, 2002. Thereafter, the parties engaged in settlement negotiations and, ultimately, agreed in principle to a settlement premised on additional disclosures. Plaintiffs withdrew their motion for preliminary injunction against the revised offer. On October 30, 2002, Unocal announced that its offer was successful, and resulted in Unocal owning 97.5% of Pure's shares. Later on October 30, Unocal completed the promised short-form merger.

VII. CONCLUSION.

The Pure Resources opinion is chock full of important and thorny issues facing corporate practitioners. It is certainly a "must read" for attorneys advising controlling stockholders considering a tender or exchange offer for the minority shares they do not own. However, there are a number of questions addressed in the opinion that are not necessarily finally resolved, such as:

- will the Delaware Supreme Court re-affirm its prior decision in Solomon and confirm that the entire fairness standard does not apply to controlling stockholder tender or exchange offers?;
- does a controlling stockholder or the target board have a duty to empower a special committee formed to consider a tender or exchange offer by a controlling stockholder to adopt a poison pill?
- although Vice Chancellor Strine clearly believed that the Pure special committee should have pushed for the power to adopt a poison pill, is there any justification under existing case law supporting the proposition that a board or a special committee can deploy a poison pill against a majority stockholder in a manner consistent with its fiduciary duties to the majority stockholder? (see, e.g., Mendel v. Carroll, 651 A.2d 297 (Del. Ch. 1994);
- must a special committee formed to consider a controlling stockholder tender or exchange offer (or other transactions in which special committees are utilized) waive the attorney-client privilege in order to

allow a reviewing court fuller access to the advice provided to the committee or else risk an adverse inference being drawn by the court?;

- will the Delaware Supreme Court (or other judges on the Court of Chancery) adopt Vice Chancellor Strine's suggestion that the use of protective devices in the context of a controlling stockholder merger (*i.e.*, a majority of the minority vote requirement or the use of a well-functioning special committee) should render the transaction subject to the business judgment rule, instead of the entire fairness standard?; and
- must an investment banker's valuation analysis always be disclosed in similar controlling stockholder tender or exchange offers, and does this holding apply to other transactions where an investment banker performs a valuation analysis?

The foregoing list is by no means meant to be all-encompassing. It merely highlights the significant issues either decided or touched upon in the Pure Resources opinion.

Practitioners should stay tuned for future developments.