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Delaware Court Provides Guidance on Tender Offers by Controlling Stockholders for Minority Shares

In the recent *Pure Resources* ruling, the Delaware courts' latest pronouncement in the area of minority buyouts cast as tender offers, Vice Chancellor Strine provides guidance on how to structure these transactions to withstand challenges under Delaware law. Strine held that a tender offer by a controlling stockholder is non-coercive (and thus not subject to the "entire fairness" standard) only when: (1) it is subject to a non-waivable majority of the *unaffiliated* minority tender condition; (2) the controlling stockholder promises to consummate a prompt short-form merger at the same price if it obtains more than 90% of the shares; and (3) the controlling stockholder has made no retributive threats.

In September 2002, Unocal Corporation, which owned 65% of the shares of Pure Resources, Inc., made an exchange offer for the 35% of Pure that it did not already own. The exchange offer had the following key features:

- A non-waivable majority of the minority tender provision, which required that a majority of the shares not owned by Unocal be tendered (with management of Pure and affiliated parties considered part of the minority).
- A waivable condition that a sufficient number of tenders be received to enable Unocal to own 90% of Pure and to effect a short-form merger.
- A statement by Unocal that it intended, if it obtained 90%, to consummate a short-form merger as soon as practicable at the same exchange ratio.

Pure established a Special Committee of independent directors with limited powers to retain independent advisors, study the offer, negotiate it with Unocal and make a recommendation on behalf of Pure in the required Schedule 14D-9, but Unocal did not grant the Committee's request that it be delegated the full authority of the Board under Delaware law to respond to the offer. Such authority, the Court suggests, would have allowed the Special Committee, among other things, to search for alternative transactions and to adopt a poison pill to block the offer.

Plaintiffs sought a preliminary injunction against the offer on the grounds that (i) the offer was inadequate and subject to entire fairness review under *Kahn v. Lynch*

Communication Systems, Inc. and its progeny; (ii) the offer was actionably coercive; and (iii) disclosures provided to Pure stockholders were materially incomplete and misleading.

After a lengthy discussion of the basis for Delaware's disparate standards of review for minority buyouts depending on their form--tender offers or mergers—Strine stated that he remained "less than satisfied that there is a justifiable basis for the distinction" between the two. Nevertheless, he declined plaintiff's request that the entire fairness standard be applied to Unocal's offer and chose to follow the *Solomon v. Pathe* line of cases, which hold that, absent coercion or disclosure violations, Delaware law will not impose a duty of entire fairness on controlling stockholders making a tender offer to acquire shares of the minority holders.

Strine found the Unocal offer to be coercive because its "majority of minority" condition included within the minority Pure management and stockholders who were directors and officers of Unocal. Apart from this flaw, he found the Unocal offer to satisfy all other requirements of "non-coerciveness."

Strine noted that "the *Solomon* line of cases does not eliminate the fiduciary duties of controlling stockholders or target boards in connection with tender offers by controlling stockholders" and "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, providing the minority with a recommendation as to the advisability of the offer, and disclosing adequate information for the minority to make an informed judgment." However, Strine held that when a controlling stockholder makes a non-coercive tender offer, "there is no duty on its part to permit the target board to block the bid through the use of the pill."

As to the disclosure claim, Strine found that certain material information had not been disclosed, including a summary of the substantive work performed by the Special Committee's investment bankers. Going beyond federal securities regulations disclosure requirements, he held that, under Delaware law, the Schedule 14D-9 must provide a summary of "basic valuation exercises" undertaken by the bankers, "the key assumptions that they used in performing them, and the range of values that were thereby generated." As a result, the Court enjoined the Unocal offer on grounds of inadequate disclosure and structural coercion resulting from the flawed majority of the minority condition. *In Re Pure Resources, Inc. Shareholders Litigation,* C.A. No. 19876, Del. Ch. October 1, 2002.

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This memorandum constitutes only a general description of the *Pure Resources* opinion. It is not intended to provide legal advice and no legal or business decision should be based on its contents. Any questions concerning the foregoing should be addressed to any of the following New York-based members of our Mergers and Acquisitions Group:

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