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Delaware Court Clarifies Judicial Standard of Review for Evaluating Director Actions Affecting a Stockholder Vote

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On August 14, 2007, the Delaware Court of Chancery issued a decision in *Mercier v. Inter-Tel (Delaware), Inc., et al.*,[1] declining to enjoin the consummation of a merger that had been approved by a majority of Inter-Tel's stockholders at a rescheduled stockholders meeting held on August 2. The stockholders meeting was originally scheduled for June 29, but had been canceled that morning when the Company's directors "knew with virtual certainty that the Merger would be defeated if the special meeting was held as scheduled." The decision is significant in that (i) it sets out to "reformulate" the well-known standard announced in *Blasius Industries, Inc. v. Atlas Corp.*,[2] which requires a "compelling justification" for directors to interfere with an exercise of the stockholder franchise, and (ii) holds that a board can take action to reschedule a vote so as to provide additional information to stockholders when the vote is imminent and the directors think the stockholders are going to make the wrong decision.

On April 26, 2007, Inter-Tel announced that it had approved an agreement with Mitel Networks Corporation, pursuant to which Mitel, in financial partnership with the private equity firm Francisco Partners, would acquire Inter-Tel in an all cash, all shares merger for $25.60 per share. Inter-Tel had been the subject of acquisition proposals since 2005, and had also suffered from an internal division pitting a majority of the board against its CEO and founder, Steven Mihaylo. While that strife would eventually lead to Mihaylo's departure as both an officer and, temporarily, director, he remained the company's largest investor and in active pursuit of gaining its control.

On May 29, 2007, Inter-Tel gave notice that a special meeting to consider the Mitel merger would be held a month from that date, with a record date of May 25. Mihaylo responded by sending a public letter to Inter-Tel's stockholders expressing his opposition to the merger and proposing, instead, a leveraged recapitalization of the Company with Inter-Tel using a combination of cash on hand and new debt to acquire up to 60% of its shares at $28 each. On June 19, ISS recommended that stockholders vote "no" with respect to the Mitel merger and expressed its dissatisfaction with Inter-Tel's purported failure to run a full-fledged auction prior to approving the Mitel merger.

As the June 29 meeting date neared, the special committee began to consider a number of factors that potentially supported the rescheduling of the meeting, including (i) Mitel's recent public announcement that it would not raise its offer; (ii) Inter-Tel's second quarter financial performance, which had not yet been publicly disclosed and fell below the Company's projections; and (iii) concerns that the "M&A market was going to lose its froth, due to tightening in the credit markets." These developments made it unlikely that Inter-Tel would receive a higher offer, and raised additional concerns as to the viability

1 C.A. No. 2226-VCS (Del. Ch. Aug. 14, 2007).

2 565 A.2d 651 (Del. Ch. 1988).

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of Mihaylo's vague recapitalization proposal. Moreover, several stockholders had indicated a preference for postponement, and ISS had indicated that its recommendation could change if the vote were postponed and the Company disclosed additional information (i.e., the Company's second quarter financial results) warranting a reconsideration of ISS's previous determination.

On the morning of the June 29 meeting date, Mitel's directors knew that the merger would fail to achieve approval if the meeting was held, but "believed the stockholders were about to make a huge mistake." Therefore, the special committee announced it had decided to reschedule the special meeting. A new meeting date of August 2 was set, with a new record date of July 9. Significantly, after the meeting was rescheduled and additional information was disclosed, ISS changed its recommendation and Mihaylo withdrew his purported recapitalization proposal. The Mitel merger was approved by an overwhelming majority of Inter-Tel's stockholders (excluding Mihaylo) at the rescheduled special meeting.

In deciding not to enjoin the Mitel merger, the Court concluded that "well-motivated, independent directors may reschedule an imminent special meeting at which the stockholders are to consider an all cash, all shares offer from a third-party acquiror" when they:

> (1) believe that the merger is in the best interests of the stockholders; (2) know that if the meeting proceeds the stockholders will vote down the merger; (3) reasonably fear that in the wake of the merger's rejection, the acquiror will walk away from the deal and the corporation's stock price will plummet; (4) want more time to communicate with and provide information to the stockholders before the stockholders vote on the merger and risk the irrevocable loss of the pending offer; and (5) reschedule the meeting within a reasonable time period and do not preclude or coerce the stockholders from freely deciding to reject the merger.

In so concluding, the Court acknowledged "the widely known reality" that application of the *Blasius* standard has been less than clear. Without deviating from the "compelling justification" standard announced in *Blasius* and more recently applied by the Delaware Supreme Court in *MM Companies, Inc. v. Liquid Audio, Inc.*,[3] the Court distinguished situations in which directors have manipulated the electoral process to entrench themselves from those, outside the director-election context or contests for corporate control, in which directors use their authority over the election process for good faith reasons, and in a manner that does not compromise the integrity of the process but seeks to encourage the best result for the stockholders. In the latter situations, the Court opined that, "consistent with the directional impulse of *Liquid Audio*," the appropriate standard of review is "a reasonableness standard consistent with the *Unocal*[4] standard," typically implicated in the context of defensive action.

Applying the *Unocal* reasonableness standard, the Court held that the burden was on the Inter-Tel directors to first identify a legitimate corporate interest that was served by their decision to reschedule the special meeting — which would require the directors to demonstrate that "their motivations were proper and

3 813 A.2d 1118 (Del. 2003).

4 *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985).

not selfish." Here, the Company's directors, who would be replaced if the Mitel merger was consummated, satisfied this first requirement because they believed that the Mitel merger was in the best interests of the stockholders, and that the stockholders would benefit from additional information and time to consider the transaction. The Court also concluded that the directors' "actions were reasonable in relation to their legitimate objective, and did not preclude the stockholders from exercising their right or coerce them into voting a particular way." The directors had simply delayed the vote for a short period and provided additional information for the stockholders to consider.