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Rethinking the *Blasius* Standard of Review: The Implications of *Mercier v. Inter-Tel (Delaware), Inc.*

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In one of its most notable decisions of 2007, the Court of Chancery found, in *Mercier v. Inter-Tel (Delaware), Inc., et al.*,[1] that a special committee had a "compelling justification" to postpone a stockholders' meeting to avoid the defeat of a merger proposal.[2] The decision is notable not only because it is one of the only examples where a Delaware court determined that the "compelling justification" standard was satisfied,[3] but also because the Court articulated a new standard of review – a modified form of the *Unocal* reasonableness standard of review – to evaluate actions influencing the outcome of corporate director elections or other stockholder votes having consequences for corporate control. Following soon on the heels of the *Inter-Tel* decision, the Court of Chancery promulgated rulings in two other matters validating, at least implicitly, certain good faith actions taken to correct errors occurring at stockholders' meetings.[4] Taken together, *Inter-Tel* and those subsequent rulings evince a willingness by the Court to be flexible when scrutinizing actions taken in connection with stockholders' meetings, such as adjournments and postponements, at least when the actions are taken in good faith, without improper motives, and in the best interests of the stockholders. The Court cautioned, however, in its more recent decision in *Portnoy v. Cryo-Cell Int'l, Inc.*,[5] that it will not tolerate circumstances in which the stockholders' franchise rights are interfered with for improper purposes.

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1 929 A.2d 786 (Del. Ch. 2007).

2 *See Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651, 661 (Del. Ch, 1988).

3 In *Inter-Tel*, the Court of Chancery noted that it was only aware of one decision in which the Court has concluded that the "compelling justification" standard had been satisfied, and, in that decision, the conclusion was in an alternative holding after the Court had already determined that the business judgment rule, and not the *Blasius* standard, applied. We also are not aware of any other decisions that have so held.

4 *See In re Bioenvision, Inc.*, C.A. No. 3284-CC, Chandler, C. (Del. Ch. Oct. 10, 2007) (Order); *Kinley v. Healthcare Acquisition Corp.*, C.A. No. 3161, Chandler, C. (Del. Ch. Aug. 27, 2007) (Transcript).

5 940 A.2d 43 (Del. Ch. 2008).

State of the Law Prior to Inter-Tel

Heightened judicial scrutiny for board actions infringing upon stockholder franchise rights grew out of the equitable power of Delaware courts. In *Schnell v. Chris-Craft Industries, Inc.*,[6] the Delaware Supreme Court held that overt efforts by a board of directors to "utilize the corporate machinery and the Delaware law" to entrench itself in office violated equitable principles governing the relationship between directors and stockholders.[7] Dismissing an argument that advancing the date of a stockholders meeting complied with both the corporation's bylaws and the General Corporation Law of the State of Delaware, the Court noted that "[i]nequitable action does not become permissible simply because it is legally possible."[8]

Since the Delaware Supreme Court's decision in *Schnell*, Delaware courts generally have applied three standards of review when analyzing board actions affecting the stockholders' franchise rights: (i) deferential review under the business judgment rule,[9] (ii) intermediate scrutiny applying a reasonableness analysis to defensive board actions under *Unocal*,[10] and (iii) heightened scrutiny under *Blasius*, which requires directors to provide a "compelling justification" when the primary purpose of the board's action is to interfere with the stockholders' franchise rights.[11] While *Unocal* established an enhanced standard of review beyond the deferential business judgment rule, the Court of Chancery in *Blasius* determined that *Unocal* was inadequate to address cases where the "primary purpose" of the board's defensive action was to disenfranchise stockholders.[12]

In *Blasius*, the Court of Chancery considered the decision of the board of directors of Atlas Corporation ("Atlas") to appoint two new directors in response to a hostile consent solicitation by the largest stockholder of Atlas, Blasius Industries ("Blasius").[13] The Atlas board had rebuffed proposals by Blasius to engage in a leveraged restructuring plan, based in part on the advice of its advisors who determined that the Blasius proposal posed significant financial risks to Atlas. When Blasius forced the issue by delivering a consent statement to Atlas calling for the board: (i) to adopt the restructuring plan, (ii) to expand from seven to fifteen members, and (iii) for

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6 285 A.2d 437 (Del. 1971).

7 *Id.* at 439.

8 *Id.*

9 *See Aronson v. Lewis*, 473 A.2d 805 (Del. 1984).

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

11 *See Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988).

12 *Id.* at 659 (citing *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985)).

13 564 A.2d at 654-55.

eight new directors nominated by Blasius to be appointed to the board, the Atlas board responded by amending the Atlas bylaws to add two new board seats immediately filled by Atlas appointees.[14] The board's decision ensured that Blasius would be unable to secure majority representation on the Atlas board.

After concluding that the Atlas board's primary purpose in expanding the size of the board from seven to nine members was to derail the attempt to elect a new board majority, the Court analyzed whether the board's action violated established equitable principles by disenfranchising Atlas stockholders. While Blasius argued that the actions of the Atlas board violated the good faith standard of *Schnell v. Chris-Craft Industries, Inc.*, Atlas claimed it was protected by the deferential business judgment rule. If the Court refused to uphold the board's actions under the deferential business judgment rule, the Atlas board argued, in the alternative, that by protecting stockholders from the unwise recapitalization plan, the board's decision to elect two new board members fell within *Unocal*'s reasonableness test.[15]

Despite evidence indicating that the Atlas board acted in good faith to avoid potential financial harm to the corporation and its stockholders, the Court struggled to balance the board's actions with the end result of thwarting the ability of the Atlas stockholders to elect a new slate of directors. Reasoning that *Schnell* is inapplicable where a board acts in compliance with equitable principles by making its decision in good faith, and *Unocal* is inadequate to address situations where directors thwart stockholders' franchise rights, the Court concluded that a heightened standard of review was required.[16] In establishing a heightened standard of review, the Court considered but rejected a *per se* rule invalidating on equitable principles all board actions taken for the primary purpose of impeding stockholders' franchise rights. In lieu of *per se* invalidity, the Court held that when stockholders establish that the primary purpose of board action is to impede stockholders' franchise rights, the burden of persuasion shifts to the board to provide a "compelling justification" for its decision.[17] The Court then found that Atlas did not have a "compelling justification" for its actions.

Although *Blasius* reaffirmed the primacy of the stockholders' franchise rights in the rubric of Delaware corporate governance, both the Court of Chancery and the Delaware Supreme Court subsequently carved out exceptions where the *Blasius* stringent "compelling justification" standard

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14 *Id*. at 657.

15 *Id*. at 657-58.

16 Id. at 660. Citing the agency-principal relationship between directors and stockholders, and the potential imbalance of power that results when boards intentionally disenfranchise stockholders, the Court found that deferential treatment under the business judgment rule was wholly inapplicable to the actions of the Atlas board.

17 *Id.* at 661.

did not apply.[18] In addition, both the Court of Chancery and the Delaware Supreme Court have struggled over the years with the outcome determinative nature of the *Blasius* standard, when applied, and the overlapping interplay between the *Blasius* and *Unocal* standards of review when the scrutinized actions are taken in response to a threat to corporate control.[19]

For example, in *Chesapeake Corporation v. Shore*,[20] the Court of Chancery considered whether *Blasius* should be reformulated, and questioned the utility of a standard of review that had proven universally fatal when applied.[21] At issue in *Chesapeake* was a dispute between two specialty packaging concerns, Chesapeake Corporation ("Chesapeake") and Shorewood Packaging Corporation ("Shorewood").[22] Each of the corporations had initiated hostile acquisition offers to acquire the other. Recognizing that it was vulnerable and that Chesapeake was a takeover-proof Virginia corporation, Shorewood implemented a series of bylaw amendments, including a supermajority provision raising the votes required to amend Shorewood's bylaws to 66 2/3%. In combination with management control of approximately 24% of Shorewood's shares, the supermajority amendment made it "mathematically impossible" for a proxy contest targeting the Shorewood board to succeed without the support of Shorewood management.[23]

While Chesapeake argued that Shorewood adopted the supermajority amendment for the primary purpose of thwarting an unfavorable stockholder vote, triggering *Blasius* scrutiny, Shorewood maintained that the amendment represented a good faith defensive measure enacted during a battle for corporate control, implicating *Unocal*. The Court was called upon to analyze

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18 *See, e.g. Stahl v. Apple Bancorp*, 579 A.2d 1115 (Del. Ch. 1990) (refusing to find that *Blasius* applied where a board had set a record date for an annual meeting, but had not yet set a date for that meeting or solicited proxies, and then decided to defer the annual meeting and explore strategic alternatives after learning of an insurgent's intent to run a proxy contest); *Stroud v. Grace*, 606 A.2d 75, 92 (Del. 1992) (finding that where a board's decision is ratified by a fully-informed stockholder vote, the board's decision should be analyzed under the deferential business judgment rule, rather than *Unocal* or *Blasius*); *Williams v. Greier*, 671 A.2d 1368, 1380 (Del. 1996) (same).

19 *See, e.g., Stahl*, 579 A.2d at 1124 (concluding that a board's decision to defer a meeting resulted from a threat to corporate control, and determining, under *Unocal*'s reasonableness test, that the decision was a proportionate response to that threat given the need for stockholders to receive additional information to make valid voting decisions and the board's intention to provide supplemental financial information to stockholders prior to the rescheduled meeting).

20 771 A.2d 293 (Del. Ch. 2000).

21 *Id.* at 319-20.

22 *Id.* at 296.

23 *Id.* at 308-09.

"an issue that our courts have struggled with for over a decade: to what extent is the *Blasius* standard of review viable as a standard of review independent of *Unocal* in a case where *Unocal* would otherwise be the standard of review?"[24]

Noting the practical day-to-day difficulty of distinguishing between good faith board actions designed to provide stockholders with more time to consider voting decisions, and entrenchment efforts enacted to preclude the legitimate exercise of stockholder rights, the Court suggested that most cases require extensive fact-finding to determine whether the *Blasius* standard even applies.[25] Citing confusion in recent decisions about whether to apply *Unocal* or *Blasius*, the Court observed that the standard of review selected by the Court typically determines the outcome of the case, with *Blasius* review signaling that the board's action will not survive judicial scrutiny, and *Unocal* review suggesting that a board decision will stand.[26] Foreshadowing the Court's skepticism of *Blasius* articulated in *Inter-Tel*, the Court concluded that a single, consistently applied *Unocal* standard would be preferable, noting that: "[i]f *Unocal* is applied by the court with a gimlet eye out for inequitably motivated electoral manipulations or for subjectively well-intentioned board action that has preclusive or coercive effects, the need for an additional standard of review is substantially lessened."[27]

Despite its expressed preference for a streamlined *Unocal* standard, the Court of Chancery ultimately applied "the law as it exists," first examining the board's defensive maneuvers under *Unocal* to find that the supermajority bylaw was preclusive to stockholder voting rights and represented a disproportionate response to the "mild threat" posed by Chesapeake's tender offer.[28] The Court then determined under *Blasius* that the primary purpose of the supermajority amendment was to disenfranchise stockholders, and that the Shorewood board had failed to offer a compelling justification for its

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24 *Id.* at 318.

25 *Id.* at 320.

26 *Id.* at 323 (citing *Carmody v. Toll Brothers, Inc.*, 723 A.2d 1180, 1193-95 (Del. Ch. 1998)) (applying both *Blasius* and *Unocal* to find a board's poison pill provision coercive). *See also Stahl v. Apple Bancorp, Inc.*, 579 A.2d 1115, 1123 (Del. Ch. 1990) (holding *Blasius* inapplicable to a board's decision to postpone its annual meeting in order to provide additional time for stockholders to consider a competing tender offer); *Unitrin, Inc. v. Am. Gen. Corp.*, 651 A.2d 1361, 1378-79 (Del. 1995) (relying upon *Unocal*'s reasonableness standard to determine the validity of a stock repurchase plan, and eschewing discussion of Blasius in reversing the Court of Chancery's decision to strike down the stock repurchase plan at issue).

27 *Chesapeake Corp. v. Shore*, 771 A.2d 293, 323 (Del. Ch. 2000).

28 *Id.* at 324, 344.

actions.[29] Having failed scrutiny under both *Unocal* and *Blasius*, the Court granted Chesapeake's motion to enjoin Shorewood's supermajority bylaw amendment.

The Court's struggle with the *Blasius/Unocal* conundrum reached a crescendo and seemingly was resolved by the Delaware Supreme Court's decision in *MM Companies, Inc. v. Liquid Audio, Inc*.[30] In a case bearing factual similarities to *Blasius*, the Delaware Supreme Court reaffirmed that when directors faced with a threat to corporate control act with the primary purpose of thwarting the stockholders' franchise rights, the *Blasius* "compelling justification" test must be satisfied before the Court will apply *Unocal*'s reasonableness and proportionality test to the board's defensive actions.

At issue in *Liquid Audio* was the decision by the Board of Directors of Liquid Audio, Inc. ("Liquid Audio") to amend its bylaws to increase the size of the board from five to seven members, and to appoint two Liquid Audio nominees to fill the new positions. That decision was made after an insurgent notified Liquid Audio of its intent to nominate persons to fill two board positions up for election at the next stockholders meeting, and to propose bylaw and charter amendments, in order to add four new members to Liquid Audio's existing five member board.[31] At Liquid Audio's annual meeting, held the following month, the insurgent's nominees were elected, but the insurgent failed to win approval of its proposal to add four new board positions.[32] The net result of the board's expansion from five to seven members and the unfavorable stockholder vote was to foil the insurgent's attempts to gain control of the Liquid Audio board. The insurgent subsequently filed an amended complaint in the Court of Chancery claiming that the decision of the Liquid Audio board to increase the size of the board one month prior to a contested proxy election violated both *Blasius* and *Unocal*.[33]

In reversing the Court of Chancery, the Delaware Supreme Court addressed the application of the *Blasius* "compelling justification" standard within *Unocal*, finding that "[t]his Court and the Court of Chancery have recognized the substantial degree of congruence between the rationale that led to the *Blasius* 'compelling justification' enhanced standard of judicial review and the logical extension of that rationale *within* the context of the *Unocal* enhanced standard of judicial review."[34] Finding that the *Blasius* and

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29 *Id.* at 345.

30 813 A.2d 1118 (Del. 2003).

31 *Id.*

32 *Id.* at 1125.

33 *Id.*

34 *Id.* at 1129 (emphasis in original).

Unocal standards of review are "*not* mutually exclusive," the Court suggested that in cases where a board's defensive action has the effect of impeding stockholder voting rights, before the Court may consider whether the board's response was reasonable and proportionate under *Unocal*, the board must *first* present a compelling justification for its actions:[35]

> As this case illustrates, such defensive actions by a board need not actually prevent the shareholders from attaining any success in seating one or more nominees in a contested election for directors and the election contest need not involve a challenge for outright control of the board of directors. To invoke the *Blasius* compelling justification standard of review *within* an application of the *Unocal* standard of review, the defensive actions of the board only need to be taken for the primary purpose of interfering with or impeding the effectiveness of the stockholder vote in a contested election for directors.[36]

A discussion of the state of the law prior to *Inter-Tel* would not be complete without a brief mention of the Court of Chancery's decision in *State of Wisconsin Investment Board v. Peerless Corporation*.[37] In that case, the Court applied the *Blasius* standard to a chairman's decision to (i) close the polls on all proposals before a stockholders meeting save one proposal relating to the corporation's stock option plan, and (ii) adjourn the meeting to a later date. If the polls had been closed on the stock option proposal, it would have been defeated. When the meeting was reconvened, the proposal passed by a slim margin. Importantly, the chairman stood to receive a material amount of any options granted under the stock option proposal. The case is important because the Court applied the *Blasius* standard despite the fact that no election of directors or other contest for corporate control was at issue. Given the chairman's interest in the proposal at issue, the Court determined that the *Blasius* standard was an appropriate standard of review. Although the Court did not apply the "compelling justification" standard because of the procedural posture of the case, it expressed skepticism that the defendants would be able to satisfy that high standard.[38]

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35 *Id.* at 1130 (emphasis in original) (quoting *Stroud v. Grace*, 606 A.2d 75, 92, n. 3 (Del. 1992)).

36 *Id.* at 1132.

37 2000 WL 1805376, Chandler, C. (Del. Ch. Dec. 4, 2000).

38 *Id.* at *15.

The Court of Chancery's Inter-Tel Decision

The Court of Chancery held in *Inter-Tel* that the decision of a special committee to postpone a meeting on the eve of a stockholder vote, for the primary purpose of avoiding with "virtual certainty" the defeat of a merger proposal, met the *Blasius* "compelling justification" test.[39] While the Court applied heightened *Blasius* scrutiny to the actions of the board in order to comply with binding precedent, Vice Chancellor Strine reaffirmed the position he expressed in *Chesapeake* that the appropriate standard of review for defensive board actions taken in the corporate control context is intermediate scrutiny under *Unocal*. Arguing further that *Blasius* has proven difficult to apply, Vice Chancellor Strine reiterated his belief that "the *Blasius* standard should be reformulated in a manner consistent with using it as a genuine standard of review that is useful for the determination of cases, rather than as an after-the-fact label placed on a result."[40]

The facts of *Inter-Tel* are straightforward. In April 2007, Inter-Tel (Delaware), Incorporated ("Inter-Tel") announced that it had reached an agreement with Mitel Networks Corporation ("Mitel"), 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.[41] 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 ("Mihaylo"). While that strife eventually led to Mihaylo's departure as both an officer and, temporarily, as a director, Mihaylo remained Inter-Tel's largest investor and continued to pursue control of Inter-Tel.

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 letter to Inter-Tel's stockholders expressing his opposition to the merger and proposing instead a leveraged recapitalization 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, Institutional Shareholder Services ("ISS") recommended that stockholders vote "no" with respect to the Mitel merger and expressed its dissatisfaction with the purported failure of the Inter-Tel board to run a full-fledged auction prior to striking a deal with Mitel.[42]

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39 *Mercier v. Inter-Tel (Del.), Inc., et al.*, 929 A.2d 786, 797, 788 (Del. Ch. 2007).

40 *Id.* at 788.

41 *Id.* at 791.

42 *Id.* at 793.

As the June 29 meeting date approached, a Special Committee of Inter-Tel's board of directors considered 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 for Inter-Tel; (ii) Inter-Tel's second quarter financial performance, which had not been publicly disclosed and fell below original projections; and (iii) concerns that the "M&A market was going to lose its froth, due to tightening in the credit markets."[43] These developments in combination made it unlikely that Inter-Tel would receive a higher offer, and raised additional concerns regarding the viability of Mihaylo's vague recapitalization proposal. Moreover, several stockholders had indicated a preference for the postponement, and ISS had intimated that its recommendation could change if the vote was postponed and Inter-Tel disclosed additional financial information warranting a reconsideration of the prior determination by ISS.

On the morning of the June 29 meeting date, Inter-Tel's directors knew that the merger would fail to achieve approval if the meeting went forward, and "believed the stockholders were about to make a huge mistake" in voting down the transaction.[44] The Special Committee therefore announced that the meeting would be rescheduled, and offered a new August 2 meeting date with a record date of July 9. Significantly, after the meeting was rescheduled and additional information was disclosed, ISS changed its recommendation from "no" to "yes" on the proposed merger agreement, and Mihaylo withdrew his recapitalization proposal.[45] The Mitel merger was approved by an overwhelming majority of Inter-Tel's stockholders (excluding Mihaylo) at the rescheduled special meeting.

In declining to enjoin the closing of the Inter-Tel merger, Vice Chancellor Strine first acknowledged "the widely known reality that our law has struggled to define with certainty the standard of review this court should use to evaluate director action affecting the conduct of corporate elections."[46] Despite confusion surrounding the correct application of heightened *Blasius* scrutiny, Vice Chancellor Strine opined that Delaware courts have nonetheless exhibited "good sense" in distinguishing between factual situations in which directors manipulated the electoral process to entrench themselves in office during a battle for corporate control from those where disinterested directors used valid authority over the election process

43 *Id.* at 796.

44 *Id.* at 797.

45 *Id.* at 802.

46 *Id.* at 805.

to encourage the best result for stockholders.[47] Nevertheless, the Court stated that the appropriate standard of review should be "a reasonableness standard consistent with the *Unocal* standard" typically invoked in the context of board defensive action.[48]

Applying a modified *Unocal* reasonableness standard to the facts of *Inter-Tel*, the Court stated that the Special Committee retained the burden of first identifying a "legitimate corporate objective" served by its decision to reschedule the special meeting, requiring that the directors demonstrate that "their motives were proper and not selfish."[49] Inter-Tel's directors, who would be replaced if the Mitel merger were consummated, satisfied this first requirement because they believed that the Mitel merger was in the best interests of stockholders, and that stockholders would benefit from additional information and time to consider the transaction.

Having shown that the meeting postponement met a legitimate corporate objective, the Inter-Tel Special Committee was then required to demonstrate that its objective in rescheduling the meeting was reasonable, and that the postponement would neither preclude stockholders from exercising their voting rights, nor coerce stockholders into voting for or against

47 *Compare Perlegos v. Atmel Corp*., C. A. Nos. 2320-N, 2321-N, 2007 WL 475453, at *27-28, Noble, V.C. (Del. Ch. Feb. 8, 2007) (distinguishing prior decisions refusing to apply *Blasius* when stockholder meetings were postponed or delayed from the facts of the instant case where a special meeting of stockholders was canceled outright), and *MM Companies, Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118, 1132 (Del. 2003) (applying *Blasius* scrutiny to defendant board's decision to appoint two new directors on the eve of a contested election for the purpose of frustrating stockholder attempts to gain control of the board), and *Chesapeake Corp. v. Shore,* 771 A.2d 293, 344 (Del. Ch. 2000) (holding *Blasius* relevant to Supermajority Bylaw implemented by board of directors as an entrenchment measure during a contest for control), and *Aprahamian v. HBO & Co.*, 531 A.2d 1204, 1206-07 (Del. Ch. 1987) (restraining board's attempt to delay imminent stockholder meeting in the face of evidence suggesting that the current board would be replaced), with *Esopus Creek Value LP v. Hauf*, 913 A.2d 593, 602-03 (Del. Ch. 2006) (declining to apply *Blasius* scrutiny to a board's decision to structure a contested transaction as a bankruptcy sale even though structure impeded stockholder rights to vote for or against the sale because, among other things, the board acted without entrenchment motives, and stockholders retained the right to elect directors), and *In re MONY Group, Inc. S'holder Litig.*, 853 A.2d 661 (Del. Ch. 2004) (holding *Blasius* inapplicable to board's decision to postpone an imminent stockholder meeting when the decision was both free of coercive intent, and in the best interest of stockholders), and *H.F. Ahmanson & Co. v. Great W. Fin. Corp.*, 1997 WL 305824, at *16, Jacobs, V.C. (Del. Ch. June 2, 1997) (finding fifty-day delay in stockholders meeting inadequate to warrant heightened *Blasius* scrutiny), and *Kidsco Inc. v. Dinsmore*, 674 A.2d 483, 495 (Del. Ch. 1995) (finding *Blasius* inapplicable to bylaw amendment enacted by defendant board of directors that provided twenty-five additional days for directors to call a special meeting of stockholders).

48 *Inter-Tel*, 929 A.2d at 810.

49 *Id.*

the proposed merger.[50] Noting that the Special Committee promptly set a new date for the postponed merger vote and that the board had promised to hold a meeting on September 12 if the merger was defeated, the Court concluded that the Special Committee had acted reasonably in delaying the vote for a short period of time in order to provide additional information to stockholders prior to the merger vote.[51] The Court also determined "summarily" that the postponement was neither preclusive nor coercive to stockholder voting rights, since stockholders of record remained free to vote either for or against the merger at Inter-Tel's rescheduled meeting.[52] The decision of the Inter-Tel Special Committee to postpone an imminent stockholder vote therefore met intermediate scrutiny under the Court's reformulated *Unocal* test.

Acknowledging the continued relevancy of the *Blasius* test after the Delaware Supreme Court's decision in *Liquid Audio*, the Court nevertheless applied the "compelling justification" standard of review. Vice Chancellor Strine held that compelling circumstances are present where: (i) stockholders are poised to reject a merger proposal that the board believes is in the best interests of the corporation, (ii) the board possesses relevant information that has yet to be disclosed to the public, and (iii) in the event of an unfavorable vote, the buyer could walk away from the transaction.[53]

In the Wake of Inter-Tel: Kinley, Bioenvision, and Cryo-Cell

Following *Inter-Tel*, the Court of Chancery issued two other rulings that underscore the Court's willingness to provide appropriate relief when actions are taken in good faith, without improper motives, and in the best interests of the stockholders. For example, in *Kinley v. Healthcare Acquisition Corporation*,[54] the Court of Chancery addressed a situation in which a calculation error led to a premature closing of the polls at a stockholders' meeting.

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50 *Id.*

51 *Id at 818.*

52 *Id.* at 817.

53 *Id.* at 819. Two additional factors relevant to meeting *Blasius*' "compelling justification" test were cited in Vice Chancellor Strine's *Inter-Tel* decision: (i) a desire to communicate with and provide more information to stockholders in the interest of retaining a valid offer, and (ii) a decision by the board to reschedule the meeting within a "reasonable" timeframe that retains stockholder rights to accept or reject the merger agreement. *Id.* at 787.

54 *Kinley v. Healthcare Acquisition Corp.*, C.A. No. 3161, Tr. at 1, Chandler, C. (Del. Ch. Aug. 27, 2007) (Transcript).

In *Kinley*, the stockholders of a special purpose acquisition corporation (a "SPAC") were asked to vote in favor of a merger transaction. As is typical in SPAC transactions, the certificate of incorporation of the corporation contained a provision that permitted the stockholders to demand, contemporaneously with their vote on a merger, the "conversion" (actually a redemption under Delaware law) of their shares of stock in lieu of participating in the merger. If 20% of the shares were subject to a demand for "conversion," then the corporation would be prevented from closing the merger. At the stockholders meeting, the merger was approved by an overwhelming number of stockholders and, according to the transfer agent, less than 20% of the shares were subject to a demand for conversion. The polls were then promptly closed. When it became apparent that the transfer agent had made an error and that more than 20% of the shares had elected to convert at the time the polls were closed, the corporation reopened the polls to permit more time for conversion demands to be withdrawn by the stockholders. After the polls were reopened, sufficient conversion demands were withdrawn so as to bring the total number of shares subject to the conversion demands to less than 20%.

At oral argument, and after hearing the argument of an objector with questionable standing, the Court granted judgment on the pleadings in favor of a plaintiff stockholder who brought suit to uphold the result attained at the reopened meeting and thus to permit the corporation to go forward with the merger. The Court was able to reach the result based on the language of the certificate of incorporation provision at issue, in particular the presence of the word "contemporaneously" in the certificate of incorporation. The Court determined that it did not need to use its equitable powers to validate the reopening of the polls because it believed that the withdrawal of the conversion demands, which occurred on the same day as the stockholder vote, was contemporaneous enough to satisfy the certificate of incorporation provision. The Court noted that its decision satisfied the "spirit and substance" of the SPAC's certificate of incorporation.[55]

In another matter that soon followed, the Court was squarely presented with whether it should exercise its equitable powers to correct yet another calculation error at a stockholders' meeting. In that matter, Bioenvision, Inc. and Genzyme Corporation, who had agreed to merge, asked the Court to provide equitable relief pursuant to Section 231(c) of the General Corporation Law of the State of Delaware to reopen the polls that had been closed at the Bioenvision, Inc. stockholders' meeting convened to vote on the merger.[56] The chairman of the meeting closed the polls in the mistaken belief that the requisite vote had been attained, but then learned that one stockholder had been unable to vote all of its shares and that the voting of

55 *Id.* at 57.

56 *In re Bioenvision, Inc.*, C.A. No. 3284-CC, Chandler, C. (Del Ch. Oct. 10. 2007) (Order).

another block of shares had been unavoidably delayed. As a result, at the time the polls closed, there were inadequate shares voted in favor of the merger.

While the joint petitioners acknowledged that they were unable to locate case law confirming that the Court of Chancery's equitable powers extended to "human errors in the voting process," the Court entered an order, without any written or oral decision, permitting Bioenvision to convene a meeting, with the same record date as the prior meeting, so that the corporation could accept all votes on the merger through the date of the new meeting. The order also provided for the extension of the appraisal rights deadline to the date of the new meeting and required Bioenvision to provide notice to the stockholders of the meeting and the order.

While the *Kinley* and *Bioenvision* rulings continue the trend articulated in *Inter-Tel* to validate actions taken in good faith, without improper motives, and in the best interests of the stockholders, the Court of Chancery's recent decision in *Portnoy v. Cryo-Cell International, Inc.*[57] reaffirms that, in cases where the stockholders' franchise rights are thwarted for improper purposes, Delaware courts will provide appropriate equitable relief.

At issue in *Cryo-Cell* were the actions taken by the chief executive officer of Cryo-Cell International, Inc. ("Cryo-Cell"), who was also the sole inside director (the "CEO"), in response to a proxy contest waged by an insurgent. The CEO formed an alliance with another stockholder group (the "Filipowski Group") and agreed to increase the size of the board by one seat effective as of the date of the annual meeting, in order to add a Filipowski Group nominee to the management slate.[58]

Before the meeting, Cryo-Cell's proxy solicitor advised the CEO that the insurgent's slate held a large lead over the management slate. Subsequently, the CEO played matchmaker by putting the Filipowski Group and another large stockholder in contact with stockholders who wanted to sell their shares (and presumably would grant a proxy to the purchaser to vote those shares). In exchange for buying additional shares, the Filipowski Group requested an additional seat on the board, a request the CEO made clear would be honored in the event that management prevailed. The CEO also pressured another large stockholder into agreeing to vote for management's slate, by threatening to withhold the corporation's cooperation on a joint project and by agreeing to provide an opinion of the corporation's counsel in order to remove a restrictive legend from that stockholder's stock certificates (an action the corporation previously had refused).

57 940 A.2d 43 (Del. Ch. 2008).

58 Filipowksi did not have industry experience and did not meet the board's own guidelines for determining the suitability of board members.

Shortly before the meeting, a large block of shares was purchased by a stockholder friendly to management; however, it was unclear whether those shares could be voted in favor of management before the polls were scheduled to close. With time of the essence, the CEO then embarked on a strategy of delay in order to provide the stockholder and the corporation with the necessary time to allow those shares to be voted before the polls closed. After the meeting had been convened for an hour and a half and the polls had been opened, the insurgent moved to close the polls and the CEO ruled that motion out of order. The CEO then instructed management to make unscheduled presentations at the meeting in an effort to provide more time for the vote to arrive. When the presentations were completed, and despite the fact that it was already mid-afternoon, the CEO decided to adjourn the meeting for an extended lunch break and to reconvene the meeting at 4:45 p.m. After the lunch break, and only after it became clear that management had secured a sufficient number of votes to prevail, the CEO reconvened the meeting and immediately closed the polls.

After reaching a number of conclusions with respect to, among other things, whether the corporation had engaged in vote buying, the Court addressed the CEO's conduct at the meeting. Distinguishing the *Inter-Tel* decision, the Court found that the CEO had breached her fiduciary duties by having taken delaying actions at the meeting. In particular, the Court found that the CEO had acted inequitably at the meeting and that the defendants had failed to prove that her actions were taken in selfless good faith. The Court noted that the CEO gave the stockholders false reasons for delay and, unlike the Special Committee in *Inter-Tel*, was not "acting in good faith to ensure that stockholders had more time to consider an arms-length transaction that was at danger in a time of economic tumult."[59] The Court concluded as follows:

> Nonetheless, it is impossible to ignore the unfairness of [the CEO's] behavior, a justification by reference to effect being no defense to actions affecting a director election that are undertaken for "an inequitable purpose" and in an inequitably deceptive manner. If an electoral contestant assumes the role of presiding over the meeting, she has an obligation to do so fairly. [The CEO] did not do so. She stalled so that her side could win the game, knowing that if the game ended when it was scheduled to end, her side would lose. Then she was dishonest about the reasons for delay.[60]

Because the Court found that the defendants had committed numerous breaches of their fiduciary duties, the Court ordered the corporation to hold a special meeting of stockholders for the election of

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59 *Id.* at 78 n.188.

60 *Id.* at 79.

directors, to be presided over by a special master. The Court ordered the management slate to bear personally the corporation's costs to hold the special meeting, as well as the costs of the special master and the corporation's proxy solicitation.[61]

Conclusion

The Court of Chancery's decision in *Inter-Tel* is notable not only because it is one of the rare decisions finding that the "compelling justification" standard was satisfied, but also because it articulated a modified *Unocal* reasonableness standard of review that the Court suggested should be applied when evaluating actions taken in connection with director elections or other stockholder votes having consequences for corporate control. Perhaps more importantly, the decision, along with *Kinley* and *Bioenvision*, underscore the willingness of the Court to address unique situations that may arise when the stockholders exercise their franchise rights, and when actions that affect those rights are taken in good faith, without an improper motive, and in the best interests of the stockholders.

61 The Court did not, however, require defendant's to bear the cost of plaintiff's proxy solicitation efforts, finding that plaintiff's hands were not entirely clean (given that plaintiff had worked with a former employee to acquire information in violation of a confidentiality agreement).