

In re Pure Resources, Inc. Shareholders Litigation, 808 A. 2d. 421 (Del. Ch. 2002)

Controlling Shareholders Held to Stringent Disclosure Requirements for Fairness Opinions

In re Pure Resources, Inc. Shareholders Litigation, suggests that controlling shareholders as well as their board of directors and special committees will be held to more stringent disclosure requirements for fairness opinions. The Delaware Court held that, as a matter of state corporate law, a corporation must provide its shareholders with full disclosure of the financial analyses underlying any fairness opinion received by the target's board of directors or special committee in connection with an acquisition by a controlling shareholder, even in tender offer transactions where this disclosure is not required by the federal securities law.

Background of the Court Case

- The lead plaintiff in this case held a large block of shares in Pure Resources, Inc. ("Pure"), 65% of the shares of which are owned by Unocal Corporation ("Unocal");
- Unocal sought to acquire the rest of Pure's shares in exchange for Unocal shares;
- The plaintiffs believed the offer was inadequate and was subject to entire fairness review. Additionally, they claimed that the defendants had not made adequate and non-misleading disclosure of the material facts necessary for Pure's shareholders to make an informed decision of whether to tender into the offer; and
- The Court concluded that the offer was not subject to the entire fairness standard, rather to the *Solomon* standards, however, preliminarily enjoined the offer because material information relevant to the Pure stockholders' decision-making process had not been fully disclosed.

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In Re Pure Resources, Inc. Shareholders Litigation

C.A. No. 19876

COURT OF CHANCERY OF DELAWARE, NEW CASTLE

2002 Del. Ch. LEXIS 116

October 9, 2002, Decided

SUBSEQUENT HISTORY:

Review denied, Shareholders Litig., Cardinal Capital Mgmt., LLC v. Amerman (In re Pure Res., Inc.), 2002 Del. LEXIS 630 (Del. Oct. 10, 2002).

PRIOR HISTORY:

In re Pure Res., Inc., S'holders Litig., 2002 Del. Ch. LEXIS 112 (Del. Ch. Oct. 1, 2002).

DISPOSITION: [*1] Plaintiffs' motion for certification of appeal denied.

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JUDGES: LEO E. STRINE, JR., VICE-CHANCELLOR.

OPINIONBY: LEO E. STRINE, JR.

OPINION: Pursuant to Supreme Court Rule 42, the plaintiffs in this action seek certification of an interlocutory appeal from this court's order of October 3, 2002. n1 Applications for interlocutory review under Rule 42 should be granted only in exceptional circumstances, balancing the public interest in "advancing appellate review of potentially case dispositive issues" while "avoiding fragmentation and delay when interlocutory review is unlikely to terminate the litigation or otherwise serve the administration of justice." n2 This court should certify an appeal only if the ruling appealed from (i) determines a substantial issue; (ii) establishes a legal right; and (iii) meets one [*2] of the criteria in Rule 42(b)(i)-(v).

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n1 I cannot help but note my dismay at the plaintiffs' moving papers. Those papers misrepresent the opinion that this court issued in support of its injunction order. It is disappointing that the talented advocates for the plaintiffs did not simply state the substantial arguments in favor of their position, arguments I endeavored to more than fairly address in my opinion, but instead resorted to distorting and inflammatory descriptions of my decision, which bear little resemblance to the opinion's actual reasoning.

n2 Donald J. Wolfe, Jr. and Michael A. Pittenger, CORPORATE AND COMMERCIAL PRACTICE IN THE DELAWARE COURT OF CHANCERY, § 14-4 at 14-5 (2000) (hereinafter "Wolfe & Pittenger").

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In the order the plaintiffs seek to appeal, this court granted a preliminary injunction against a then-pending exchange offer made by Unocal Corporation to the stockholders of Pure Resources Corporation. The exchange offer at that time offered Pure stockholders 0.6527 of Unocal share [*3] for each Pure share they owned. That offer was opposed by Pure's Special Committee. The 0.6527 offer was the only one on the table when this court ruled.

The day after the court's injunction decision, Unocal indicated a willingness to increase its bid, largely (it appears) because Pure's stockholders had not tendered many shares at the original offering price. Just today, Unocal announced an increase in its bid to 0.74 a Unocal share for every Pure share, an offer that is now set to expire on October 24. The Pure Special Committee apparently supports that increased offer. Notably, the evidentiary record before this court does not (for obvious reasons) involve that higher bid and this court's opinion did not address it or the negotiations that led to the Special Committee's approval of it.

Although the court's order addressing the original offer granted the plaintiffs substantial relief, it did not give the plaintiffs all they sought; to wit, an injunction blocking the 0.6527 exchange offer on the grounds that: 1) the entire fairness standard governed the review of that exchange offer and was unlikely to be satisfied; and 2) Unocal, as majority stockholder of Pure, and Pure's directors [*4] breached their fiduciary duties by failing to empower Pure's Special Committee to, among other things, deploy a shareholder rights plan or "poison pill" to block that exchange offer. Obviously, these issues are to some extent related, because the plaintiffs argued that the failure to so empower the Special Committee, and therefore for the Special Committee to use that power to block the original exchange offer, was evidence of unfairness.

In the opinion underlying my order, I did not find favor with these arguments. Instead, I relied on a line of cases, which can be traced back at least as far as *Lynch v. Vickers Energy Corp.*, n3 and perhaps even further. These cases -- which include the recent Supreme Court decision in *Solomon v. Pathe Communications Corp.* n4 -- stand for the proposition that a majority stockholder owes no duty to offer or to pay a particular price in a tender offer made to the subsidiary shareholders. In a transaction of that kind, the majority stockholder complies with its fiduciary duties so long as it does not wrongly coerce the minority or fail to disclose fairly the material facts bearing on the minority's decision whether to tender. This line of tender [*5] offer cases is an unbroken one; that is, the decisions of the trial courts are not in any way in conflict upon this question. Therefore, Supreme Court Rule 41(b)(ii) is not satisfied. Nor is Supreme Court Rule 41(b)(i), because this is not the first time our courts have faced this issue.

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n3 351 A.2d 570 (Del. Ch. 1976), *rev'd on other grounds*, 383 A.2d 278 (Del. 1977).

n4 672 A.2d 35 (Del. 1996).

----- End Footnotes-----

As the plaintiffs point out, however, the *Solomon* line of cases rests on reasoning that, at least in part, can be seen as reflecting a somewhat different policy emphasis than the separate line of cases dealing with negotiated mergers between controlling stockholders and subsidiaries, a line associated with the important decision in *Kahn v. Lynch Communications Systems, Inc.* n5 Moreover, the recent decision in *Glassman v. Unocal Exploration Corp.* n6 brought this arguable tension to the fore, because *Glassman* and *Solomon* together seemed to clear a relatively [*6] non-litigious path for controlling stockholders seeking to acquire subsidiary shares: make a tender offer to be followed by a short-form merger under 8 Del. C. § 253.

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n5 638 A.2d 1110 (Del. 1994).

n6 777 A.2d 242 (Del. 2001).

----- End Footnotes-----

The present application for certification of an interlocutory appeal places me in an odd position. Defendant Unocal supports the application. The Special Committee defendants take no position. The other members of the Pure board who are defendants provide a lengthy explanation of why it might not make sense to certify the appeal, but do not actively oppose certification. In the absence of helpful adversary argument, it is more difficult to decide whether to certify the appeal. Nonetheless, the parties' failure to argue the question does not relieve me of the obligation to rule and I shall.

The first requirement of Supreme Court Rule 42(b) appears to have been met, because it is difficult to say that determining that the entire [*7] fairness standard does not apply to the exchange offer did not "determine[] a substantial issue," even though that ruling was made on a motion for preliminary injunction.

Whether the second requirement of Rule 42(b) -- that the injunction order establishes a legal right -- is satisfied is far more doubtful. In the federal system, any denial of a preliminary injunction gives rise to appellate rights. That is not true in our system. Is the absence of an injunction that is as extensive as the plaintiffs demanded the establishment (or phrased negatively, the denial) of a legal right? Certainly, there have been many cases in which the denial of an injunction has been thought to have this effect because of the possibility that irreparable harm would occur absent an injunction. Here, however, the injunction I did enter is, in my view, fully adequate to ensure that Pure stockholders will not be coerced or misled into tendering into the revised offer. The main purpose of the broader injunction that the plaintiffs apparently still seek is to ensure that the Pure stockholders do not accept an offer at a price lower than might be obtained if an injunction is entered, which in turn leads to [*8] either enhanced bargaining power for the Special Committee or creates practical pressures that generate (an even higher) higher bid by Unocal.

In an injunction setting like this one, this court is always quite worried that the entry of an injunction in the absence of wrongful coercion or disclosure will deprive the stockholders of a valuable opportunity to sell. The availability of later monetary damages here seems to limit the possibility of irreparable injury markedly, except to the limited extent that it will be impossible for the court's damage award to replicate precisely the price that would have resulted if the enhanced exchange offer had been negotiated by Unocal and Pure in accordance with the plaintiffs' view of: (i) appropriate fiduciary behavior and (ii) the required allocation of board authority to the Special Committee.

Candidly, the press of time and the absence of helpful submissions make it impossible for me to do an in-depth review of prior authority to determine whether the second requirement of Rule 42(b) is, based on case precedent, satisfied in a situation posing only this (largely theoretical) risk of irreparable injury. My inclination, therefore, is to be [*9] somewhat lenient and to accept the plaintiffs' (somewhat exaggerated) view that the absence of a more complete injunction will deprive them of the "legal right" to stop this transaction altogether. In this regard, I note that Rule 42(b) applications have frequently been granted in corporate cases involving the denial of an injunction and this case would not be exceptional in that regard. n7

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n7 *Wolfe & Pittenger*, at § 14-4[c] (noting prevalence of interlocutory review in cases raising important questions of entity law).

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Assuming the first two requirements of Rule 42(b) have been met, the question is whether one of the criteria in Rule 42(b)(i)-(v) are met. To my mind, the only one that possibly is implicated here is the criterion in Rule 42(b)(v) that permits certification when that would "serve considerations of justice." In this respect, I am particularly sensitive to Unocal's desire for transactional certainty. It may well choose to withdraw its enhanced exchange offer if the plaintiffs prevail on appeal. [*10]

Although I am sympathetic to Unocal's wish for certainty, I remain unconvinced that considerations of justice weigh in favor of an immediate interlocutory appeal. Since the injunction order was entered, Unocal substantially increased the value of its exchange offer. The Pure Special Committee now supports the revised bid. Thus, the facts (about process and price) have proceeded in a manner that the evidentiary record has not caught up to.

This factor -- the state of the record -- undercuts the utility of an immediate appeal. The lead plaintiff's view of fair value is, to date, inscrutable -- indeed, its moving papers on the injunction motion made no substantial argument that the original exchange ratio was unfair, focusing instead on the fact that a better process would have resulted in a better price. Given the absence of reliable economic evidence in the record that the original price was unfair (as opposed to whether it was Unocal's highest bid), the Supreme Court will be in a more difficult position to decide whether to enjoin the enhanced offer, because it will be forced to risk denying the Pure stockholders the option whether to make the voluntary decision to accept the Unocal [*11] bid without evidence that could give it a firm basis to opine confidently that an injunction would do more good than harm. In view of the overall weakness of the plaintiffs' irreparable harm argument, this factor weighs heavily against the advisability of certification.

By contrast, the consideration that inclines most towards certification is the benefit that could be achieved by having our Supreme Court decide whether to re-affirm the *Solomon* standard, in view of the developments, including *Glassman*, that have occurred since *Solomon* was first decided. But the utility of that type of decision can be achieved even more reliably and less burdensomely later. After the dust has settled, either: (i) a ruling on summary judgment as to the standard of review can be certified or (ii) a prompt schedule can be put in place that will produce a final, appealable order within the year. Either approach will facilitate timely appellate consideration of the important legal issues raised by the case and will receive my favorable consideration, after consultation by the parties on the

route that is the most efficient. Following this alternative course would ensure that the Supreme Court [*12] 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. Because the original injunction eliminated any structural coercion and addressed the key informational concerns of the plaintiffs and because monetary damages remain a potent remedy for the plaintiffs, I perceive no exigency that warrants foisting an expedited appeal on the Supreme Court to address a situation that has evolved beyond the trial court record's scope.

For all these reasons, therefore, I do not believe certification at this stage serves considerations of justice, and the plaintiffs' motion for certification is hereby denied. IT IS SO ORDERED.

Leo E. Strine, Jr.