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DELAWARE SUPREME COURT EXAMINES INTERPLAY OF SCHNELL "INEQUITABLE PURPOSES" DOCTRINE AND BLASIUS "COMPELLING JUSTIFICATION" STANDARD IN ADDRESSING BOARD INTERFERENCE WITH STOCKHOLDER VOTE

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DELAWARE CORPORATE LAW BULLETIN

DELAWARE SUPREME COURT EXAMINES INTERPLAY OF *SCHNELL* "INEQUITABLE PURPOSES" DOCTRINE AND *BLASIUS* "COMPELLING JUSTIFICATION" STANDARD IN ADDRESSING BOARD INTERFERENCE WITH STOCKHOLDER VOTE

Confirms that Schnell and Blasius review "can be folded into Unocal to accomplish the same ends"

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INTRODUCTION

Acknowledging that "our corporate law is not static," in *Coster v. UIP Companies, Inc.*, No. 163, 2022 (Del. Sup. Ct. June 28, 2023) ("*Coster IV*"), the Delaware Supreme Court ("*Supreme Court*") sought to reconcile several standards of judicial review utilized by Delaware courts over the years to address challenges to corporate board actions alleged to have impeded the stockholder franchise. This is not an insignificant issue: "[t]he shareholder franchise is the ideological underpinning upon which the legitimacy of directorial power rests" under Delaware corporate law.

Coster IV represents (presumably) the culmination of a three-and-one-half year judicial odyssey involving two decisions of the Delaware Court of Chancery ("*Chancery Court*") and two more of the Supreme Court:

- *First,* a decision delivered by then-Vice Chancellor (now Chancellor) Kathaleen St. J. McCormick (herein referred to as "*the Chancellor*") in *Coster v. UIP Companies, Inc.*, 2020 WL 429906 (Del. Ch. Jan. 28, 2020) ("*Coster I*").
- *Second,* the Supreme Court's reversal and remand of *Coster I* in *Coster v. UIP Companies, Inc.*, 255 A.3d 952 (2020) ("*Coster II*").
- *Third*, the Chancellor's decision on remand in *Coster v. UIP Companies, Inc.*, 2022 WL 1299127 (Del. Ch. May 2, 2022) ("*Coster III*").
- And, *finally*, the Supreme Court's affirmance of *Coster III* in *Coster IV*. *Coster I*, *Coster II*, *Coster III*, and *Coster IV* are herein referred to collectively as the "*Coster Decisions*," and quotations contained herein without specific authority are quotations from one of the *Coster Decisions*.

A review of key precedent is appropriate before we address the *Coster Decisions*.

A. Legal Background—Judicial Standard of Review

When the Delaware court considers a stockholder action alleging breach of fiduciary duty by corporate directors, the typical first step in the analysis is fixing the applicable standard of review. As noted by Chancellor McCormick in *Coster I*, "[i]dentification of the correct analytical framework is essential to a proper judicial review of challenges to the decision-making process of a corporation's board of directors."

There are several standards of review available to Delaware courts. Under the default, and most deferential, standard, the business judgment rule, "a decision made by a loyal and informed board will not be overturned by the courts unless it cannot be attributed to any rational business purpose." At the other end of the spectrum is the entire fairness standard, the most exacting standard applied to actions taken by a conflicted board majority or control stockholder. When entire fairness is invoked, the defendants are required "to establish that the underlying transaction was 'the product of both fair dealing *and* fair price.' "

Delaware courts have developed other standards to address particular circumstances where neither business judgment nor entire fairness review seemed appropriate. Perhaps the most famous is the two-part intermediate test of reasonableness, known as enhanced scrutiny, applied to (i) corporate defensive measures (*see Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) ("*Unocal*")) and (ii) sales of corporate control (*see Revlon Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986) ("*Revlon*")). In *Unocal,* the Supreme Court applied an enhanced standard of review to decide whether the directors "had reasonable grounds for believing that a danger to corporate policy and effectiveness existed" and that the board's response was "reasonable in relation to the threat posed."

Two other standards address circumstances in which boards have acted to thwart or otherwise interfere with the stockholder franchise in the context of a battle for corporate control:

- In *Schnell v. Chris-Craft Indus., Inc.*, 285 A.2d 437 (Del. 1971) ("*Schnell*"), an "incumbent board took admittedly legal action to move up the annual meeting date and change the location . . . to a remote destination," thereby "prevent[ing] a dissident slate from waging an effective election campaign." The Supreme Court, emphasizing that "inequitable action does not become permissible

simply because it is legally possible," reversed a Chancery Court ruling upholding the board's actions. The *Schnell Court* determined that "the board's purposeful manipulation of the election machinery to entrench themselves violated the board's duty to act equitably toward stockholders." Under the *Schnell* framework, "director actions are 'twice-tested,' first for legal authorization, and second for equity."

- In *Blasius Indus., Inc. v. Atlas Corp.*, 564 A.2d 651 (Del. Ch. 1988) ("*Blasius*"), Blasius Industries, Inc. ("*BII*"), a ten percent stockholder of Atlas Corporation ("*Atlas*"), sought Atlas stockholder support to increase the Atlas board "from seven to fifteen members and elect[] eight new directors nominated" by BII. If elected, the new board majority would champion a BII-sponsored leveraged recapitalization. In response, the Atlas board added two new members, effectively blocking BII's efforts to elect a board majority. Because it concluded that the Atlas board was acting in "good faith" to stymie a leveraged recapitalization it feared would harm Atlas's business, the Chancery Court declined to apply *Schnell*. Nevertheless, the Chancery Court "enjoined the board expansion because the board failed to demonstrate a *compelling justification* for its actions." (emphasis added)

B. Coster Decisions

The *Coster Decisions* address the relationship between *Schell* and *Blasius* in the context of a sale, authorized by the board of directors ("*Board*") of UIP Companies, Inc. ("*UIP*" or "*Company*"), of a one-third interest in the Company to a valued employee ("*Stock Sale*"). The Stock Sale broke a deadlock between UIP's two fifty percent stockholders. One of these stockholders, blocked by the other from joining the Board, asked the Chancery Court to (i) cancel the Stock Sale and (ii) appoint a neutral custodian to manage the Company. In support of her suit, plaintiff claimed the Board's approval of the Stock Sale inequitably interfered with her voting and statutory rights under Delaware law.

- In *Coster I*, rather than invoking either *Schnell* or *Blasius*, Chancellor McCormick applied the entire fairness standard to what she viewed as an interested transaction—the Stock Sale—authorized by the conflicted Board. And upon determining that the Stock Sale was entirely fair, the Chancellor, without considering the

Board's motivations or the underlying context, refused to enjoin the transaction. In the Chancellor's opinion, "[b]ecause the Stock Sale satisfies Delaware's most onerous standard of review, this decision does not reach Plaintiff's alternative arguments."

- *On appeal* in *Coster II,* the Supreme Court reversed *Coster I*, opining that the Chancellor erred in relying solely on an entire fairness review of the Stock Sale. The Supreme Court then remanded the case for the Chancellor "to consider the board's motivations and purpose for the Stock Sale" as part of a "*Schnell/Blasius* review."
- *On remand* in *Coster III,* after determining there "were genuine motivations" behind the Stock Sale "that stood alongside the more problematic purposes," Chancellor McCormick concluded that (i) the Board "did not approve the Stock Sale for inequitable purposes under *Schnell*" and (ii) the "significant business reasons for approving the Stock Sale . . . provide a compelling justification" for the Stock Sale for purposes of *Blasius*. Accordingly, the Chancellor again declined to enjoin the Stock Sale.
- Finally, in *Coster IV*, the Supreme Court not only affirmed *Coster III*, but proceeded to address concerns raised by the Chancellor with the competing and imprecise legal standards she had been directed on remand to apply. For the *Coster IV* Court, amelioration of the Chancellor's concerns lay in the familiar two-pronged framework of the *Unocal* analysis, "applied with the sensitivity" needed "to protect the fundamental interests at stake—the free exercise of the stockholder vote as an essential element of corporate democracy."

I. FACTUAL BACKGROUND

A. UIP Principals Discuss Buyout Strategies

UIP, "a real estate investment services company" formed in 2007, engages in asset management, general contracting, and property management services through three subsidiaries. UIP's three founders, Wout Coster ("*Coster*"), Cornelius Bruggen ("*Bruggen*"), and Steven Schwat ("*Schwat*")," adopted this structure "to control the management and development of" investment properties "in the Washington, D.C. metropolitan area," consisting primarily of "real estate investments of

special purpose entities ("*SPEs*") . . . in which UIP principals invest their own capital alongside third-party equity sponsors."

Initially, each founder owned one-third of UIP's outstanding shares. The five-person UIP board of directors ("*Board*") included the three founders and two key employees, Peter Bonnell ("*Bonnell*") and Stephen Cox ("*Cox*"). Upon his retirement in 2011, Bruggen "tendered his stock to UIP, leaving Wout and Schwat each with a one-half interest . . . ." When, two years later, Coster informed the Board of his serious illness, "[t]he UIP principals began succession planning, which included de-equitizing" Coster. These conversations continued into 2014, resulting in an April term sheet contemplating a "gradual transfer of [Coster]'s fifty percent ownership in UIP . . . to Bonnell" and another Company employee. The term sheet also proposed that Coster's wife, Marion (herein referred to as "*Plaintiff*"), "would receive lifelong health insurance and an undetermined future salary."

Ultimately, the principals could not agree on a valuation for the Company and, in January 2015, Coster "emailed that the terms were 'no longer a palatable deal.' " When Coster died on April 8, therefore, there was no succession plan in place. Although she inherited Coster's illiquid UIP shares and certain investment entities, Plaintiff was "very distressed about her financial situation" and feared she "must sell her home." Although Plaintiff and her representatives met with Schwat and his representatives over the course of the next three years to discuss a buyout, valuation remained an unyielding impediment.

B. Fifty Percent Stockholders Deadlock Over Board Election

Frustrated with the lack of progress, on April 4, 2018, "Plaintiff called for a special meeting of the stockholders of UIP to elect new members of the Board." At the time, Board seats previously held by Coster and Bruggen remained vacant. At the meeting, held on May 22, Schwat used his fifty percent interest to block Plaintiff's proposal to, among other things, elect five directors: Schwat, Bonnell, Plaintiff, and two Plaintiff designees.

At a subsequent meeting, held on June 4, Schwat proposed that he, Bonnell, and Cox be elected "to serve as directors until UIP's next annual meeting . . . ." Plaintiff used her fifty percent interest to defeat this proposal. Thus, Schwat and Plaintiff were effectively deadlocked.

C. Plaintiff Asks Chancery Court to Intervene

On June 15, Plaintiff asked the Chancery Court ("*Custodian Action*") to "impose a neutral tie-breaker to facilitate director elections"

through "appointment of a custodian" having "broad oversight and managerial powers." In response, Schwat arranged for the Board to (i) retain McLean Group LLC ("*McLean*") to calculate a valuation for UIP and (ii) sell shares representing a one-third stake in UIP to Bonnell ("*Stock Sale*"). Pricing for the Stock Sale was based on McClean's calculation ("*McLean Valuation*") of "the fair market value of a 100-percent, noncontrolling equity interest in UIP to be $123,869." Following the Stock Sale, Plaintiff, Schwat, and Bonnell each owned a one-third interest in UIP.

Next, Schwat asked the Chancery Court to dismiss the Custodian Action, arguing that the Stock Sale mooted the need for a custodian to break the deadlock. In response, on August 22, Plaintiff asked the Chancery Court to cancel the Stock Sale, claiming the Board breached its fiduciary duties.

D. Coster I: Chancellor Upholds Stock Sale

Because two of the three Board members were interested in the transaction, Chancellor McCormick "reviewed the Stock Sale under an entire fairness standard of review," with the burden on Schwat to "prove that the Stock Sale was entirely fair to" Plaintiff. "[A]lthough the process behind the Stock Sale 'was by no means optimal,' " use of the McLean Valuation "led the [Chancellor] to conclude that the price had been set after a fair process." Further, "[a]s to fair price," the Chancellor "similarly found that the McLean Valuation was the most reliable indicator of UIP's fair value . . . ."

Because the Stock Sale was entirely fair, Chancellor McCormick considered "the board's motives . . . 'beside the point.' " In other words, "it was unnecessary to review the Stock Sale under any less rigorous standard of review if the stock issuance passed the most rigorous entire fairness review." With the stockholders "no longer deadlocked," the Chancellor "declined to appoint a custodian . . . ."

E. Plaintiff Asks Supreme Court to Intervene

Plaintiff appealed the Chancellor's ruling, arguing she "erred by limiting [her] inquiry to entire fairness." Instead, Plaintiff invoked both *Schnell* and *Blasius*: while the Board might have "the legal authority to issue UIP stock" to Bonnell, Plaintiff argued, it could not do so "inequitably . . . to dilute her ownership interest, defeat her voting and statutory rights, and entrench themselves in office." Moreover, "even if the board had innocent reasons for the Stock Sale, . . . the Stock Sale interfered with [Plaintiff's] statutory and voting rights," requiring "the board

. . . to prove that it had a compelling justification for the stock issuance, which it failed to do."

II. *COSTER II*: THE SUPREME COURT'S ANALYSIS ON APPEAL

A. Standard of Review: Schnell/Blasius

On appeal, the Supreme Court did not take issue with Chancellor McCormick's determination in *Coster I* "that the board sold UIP stock to Bonnell at a price and through a process that was entirely fair." When considered "[i]n a vacuum, it might be that the price at which the board agreed to sell the one-third UIP equity interest to Bonnell was entirely fair, as was the process to set the price for the stock."

The Supreme Court did take issue, however, with the Chancellor's conclusion that the "entire fairness analysis was the end of the road for judicial review." In effect, "where, as here, an interested board issues stock to interfere with corporate democracy and that stock issuance entrenches the existing board," the fairness inquiry alone is not sufficient.

- Under a *Schnell* analysis, "[i]f the board approved the Stock Sale for inequitable reasons, the Court of Chancery should have canceled the Stock Sale." "[W]here boards of directors deliberately employ[] various legal strategies either to frustrate or completely disenfranchise a shareholder vote … [t]here can be no dispute that such conduct violates Delaware law."
- Under a *Blasius* analysis, although *Schnell* does "not apply when the board acts in good faith, if the board nonetheless acts for the primary purpose of impeding stockholders' franchise rights, the board must prove a 'compelling justification' for its actions." Thus, "if the board, acting in good faith, approved the Stock Sale for the 'primary purpose of thwarting' [Plaintiff's] vote to elect directors or reduce her leverage as an equal stockholder, it must 'demonstrat[e] a compelling justification for such action' to withstand judicial scrutiny."

On this basis, the *Coster II* Court reversed *Coster I* insofar as it relied "on the conclusive effect of its entire fairness review," and remanded for the Chancellor "to consider the board's motivations and purpose for the Stock Sale." In short, *Coster I*'s conclusion that "the Stock Sale was at an entirely fair price did not substitute for further equitable review when [Plaintiff] alleged that an interested board approved the Stock Sale to interfere with her voting rights and leverage as an equal stockholder."

B. Factors Indicating Board Acted for Inequitable Reasons

At the conclusion of *Coster II*, the Supreme Court provided a list of "bullet points" that, in its view, "support the conclusion, under *Schnell*, that the UIP board approved the Stock Sale for inequitable reasons . . . ." The Supreme Court also recognized, on the other hand, that the Chancellor "made other findings inconsistent with this conclusion." Accordingly, the Supreme Court provided the Chancellor with "an opportunity to review all of [her] factual findings in any manner [she] sees fit in light of [her] new focus on a *Schnell/Blasius* review."

III. *COSTER III*: CHANCELLOR MCCORMICK'S ANALYSIS ON REMAND

As explained in more detail below, Chancellor McCormick seemingly approached *Coster II*'s remand instructions with trepidation. The Chancellor divided her *Coster III* analysis into three segments: (i) a review of the factual findings, (ii) a *Schnell* analysis, and (iii) a *Blasius* analysis. At the end, she concluded that the Stock Sale passed muster under both *Schnell* and *Blasius*. Accordingly, as in *Coster I*, she allowed the Stock Sale to stand.

A. Clarification of Incomplete Narrative

Chancellor McCormick noted at the outset that the "bullet points" listed at the conclusion of *Coster II* seemingly "supported a determination that UIP's board acted for inequitable purposes under *Schnell*." Those "bullet points," she cautioned, "do not capture the full picture." Rather, there were "genuine motivations" for the Board's actions "that stood alongside the more problematic purposes" and, ultimately, outweighed the "problematic" factors. On this basis, the Chancellor concluded that "[t]he UIP board's desire to reward and retain an essential employee, implement an agreed-upon succession plan, and avoid value-destructive litigation were not, in the words of *Blasius*, 'pretexts for entrenchment for selfish reasons.' Nor were they . . . 'post-hoc justifications.' "

The Chancellor next turned to the two-part question posed by *Coster II*:

- "Did the UIP board approve the Stock Sale for 'inequitable purposes' under *Schnell*?"
- "Or, did the UIP board, 'acting in good faith,' approve the Stock Sale for the 'primary purpose of thwarting [Plaintiff's] vote to elect directors or reduce her leverage as an

equal stockholder' and without a 'compelling justification' under *Blasius*?"

B. Schnell Analysis

As noted above, Chancellor McCormick approached her *Schnell* analysis with a degree of trepidation, pointing out numerous shortcomings, uncertainties, and questions in *Schnell*'s language and application. Consider the following:

- Schnell is "a decision exceptionally modest in length" that has "done a lot of work in Delaware jurisprudence."
- "As a seminal decision securing the role of equity in corporate accountability, *Schnell* has been widely praised." On the other hand, "[a]s a standard, *Schnell* has been widely criticized."
- In the words of one commentator: "*Schnell* is insufferably vague in the sense that it supplies a judge with no real 'boundaries or guideposts[ ] to invalidate otherwise legal conduct.' "
- By "creating a *per se* rule of illegality that directs an inflexible form of relief when its application is triggered," the *Schnell* standard "stands in contrast to modern, two-part equitable standards [*see Unocal*, *Revlon*, and *Blasius*] that evaluate both the subjective and objective aspects of a board's action. Compared to modern standards, *Schnell*'s vagueness and relative inflexibility render it an inferior tool for addressing fiduciary conduct."
- "Had *Schnell* been litigated after the creation of intermediate standards [in *Unocal* and *Revlon*], the high court easily could have applied an intermediate standard, rather than an elliptical and seemingly *per se* rule."
- The elusive nature of *Schnell* as a standard and the potentially harsh consequences of its application provide good reasons to limit *Schnell*'s application. These aspects of *Schnell* have led the Delaware Supreme Court to instruct that *Schnell* "be invoked sparingly."
- The late Chancellor William T. Allen, the author of *Blasius*, "would later clarify his intent that . . . the possibility of a good faith basis for a disenfranchising action weighed in favor of supplanting the *per se* rule of *Schnell* with the more flexible two-step approach of *Blasius*."
- But since "Delaware law . . . did not clearly evolve in the direction urged by Chancellor Allen . . . it is an open issue

whether *Blasius* displaced *Schnell* as the standard applicable when a board action impedes the stockholder franchise. Perhaps there is hope yet . . . ."

- And, even if "*Blasius* must be interpreted as a carve-out to *Schnell* for disenfranchising actions taken in good faith . . . the line between *Schnell* and *Blasius* is still difficult to draw." For instance:
    - "Does *Schnell* apply to board actions lacking any good faith basis or all board actions having any bad faith motivation?"
    - "Must the court look to the directors' subjective intent in making this determination?"
    - "Does the court presume bad faith where no business justification for the action can be credibly defended or otherwise discerned?"

Ultimately, Chancellor McCormick found herself "in a world where *Blasius* does not entirely displace *Schnell* as the standard applicable where a board purposefully disenfranchises stockholders." Therefore, she concluded, "it seems inescapable that justifications inform the choice of a standard." And "[h]eeding the policy determination that *Schnell* should be deployed sparingly," the Chancellor "interpret[ed] *Schnell*, when considered in the category of stockholder-franchise challenges, as applicable in the *limited scenario* wherein the directors have *no good faith basis* for approving the disenfranchising action." (emphasis added) The presence or lack of a "good faith basis" may be gleaned from either "subjective intent" or "when objective evidence discredits proffered business reasons for the decision" as "pretextual."

Applying this narrow formulation of the *Schnell* analysis to the "multiple purposes and motivations" in the factual record—some "problematic" and others "motivated to advance the best interests of UIP" —the Chancellor opined that the Board "did not act exclusively for an inequitable purpose." In other words, "[g]iven the presence of good faith bases for approving the Stock Sale, the first question posed [in *Coster II*] can be answered in the negative: No, the UIP board did not approve the Stock Sale for inequitable purposes under *Schnell*."

C. Blasius Analysis

Turning to the *Blasius* analysis, Chancellor McCormick concluded that "the Stock Sale was for the *primary purpose* of mooting the Custodian Action." (emphasis added) While this may have been "an equitable purpose, in the sense of action that was in the best interests of the Company," the Chancellor "nevertheless assume[d,]" for purposes

of her opinion, "that a desire to moot an action brought to appoint a custodian under . . . the DGCL due to a deadlock between 50-50 stockholders is a purpose that triggers *Blasius*."

Next, the Chancellor considered "whether the UIP board had a compelling justification for" the Stock Sale. Under *Blasius*, "[t]o satisfy the compelling-justification standard," Schwat and the Board bore the burden of proving "their actions were reasonable in relation to their legitimate objective, and did not preclude the stockholders from exercising their right to vote or coerce them into voting a particular way." Approaching this question with the requisite "gimlet eye," Chancellor McCormick noted that "to date this court has found compelling justifications under *Blasius* in limited circumstances."

Coster III proved to be the exception to this rule: the circumstances surrounding the Stock Sale were, in the Chancellor's opinion, "exceptionally unique." Not only was the "broad relief sought by Plaintiff in the Custodian Action . . . an existential crisis for UIP," but Schwat and the Board "proved that the Stock Sale was appropriately tailored to achieve the goal of mooting the Custodian Action while also achieving other important goals, such as implementing the succession plan that [Coster] favored and rewarding Bonnell." Further, rather than "pursu[ing] a course that would enhance Schwat's authority"—such as issuing additional shares to Schwat or to others over which Schwat held voting authority—the Stock Sale "made Bonnell the swing vote and deprived both incumbent 50% owners of their blocking rights." While Schwat and Bonnell "currently have a good working relationship" and were aligned on the Stock Sale, there were no "future obligations . . . to vote as a block" and the two had "disagreed on a number of business decisions" in the past.

Ultimately, Chancellor McCormick determined that the Board "had significant business reasons for approving the Stock Sale, . . . provid[ing] a compelling justification for the UIP board's action." This finding was buttressed by "knowing that the ultimate solution to the deadlock—the Stock Sale—was consistent with the succession plan . . . devised on a clear day before deadlock emerged" and was "achieved [on] terms that [*Coster I*] found to be entirely fair."

IV. *COSTER IV*: SUPREME COURT ADOPTS *COSTER III* ANALYSIS

The *Coster IV* Court, without directly addressing Chancellor McCormick's concerns with the *Schnell*/*Blasius* dichotomy, sought to provide a workable framework for future analysis. In essence, the Supreme Court turned to the familiar two-part analysis adopted in *Unocal* to address defensive measures implemented by a corporate board to

defend against a takeover attempt. And, in affirming both the Chancellor's analysis and legal conclusions, the *Coster IV* Court essentially recast her approach into a *Unocal* analysis, with special regard for the sensitive issue of stockholder voting rights at the heart of the dispute. From the Supreme Court's perspective, Chancellor McCormick essentially got it right.

A. Judicial Developments post-Schnell/Blasius

First, the Supreme Court noted that *Schnell* has been "reserved . . . for 'those instances that threaten the fabric of the law, or which by improper manipulation of the law, would deprive a person of a clear right.' " As such, "the Chancellor was correct in this case to cabin *Schnell* and its equitable review to those cases where the board acts within its legal power, but is motivated for selfish reasons to interfere with the stockholder franchise."

Next, the *Coster IV* Court discussed the relationship between *Blasius* and *Unocal*, noting with approval that Chancellor McCormick "interpreted *Blasius* with a sensitivity to how, in practice, the Supreme Court and the Court of Chancery have effectively folded *Blasius* into *Unocal* review." In this connection, the Supreme Court discussed two key decisions:

- In *Stroud v. Grace*, 606 A.2d 75 (Del. 1992), the Supreme Court explained that

  > a court must recognize the special import of protecting the shareholders' franchise within *Unocal*'s requirement that any defensive measure be proportionate and "reasonable in relation to the threat posed." A board's unilateral decision to adopt a defensive measure touching "upon issues of control" that purposefully disenfranchises its shareholders is strongly suspect under *Unocal*, and cannot be sustained without a 'compelling justification.

- Then, in *MM Cos., Inc. v. Liquid Audio, Inc.*, 813 A.2d 1118 (Del. 2003) ("*Liquid Audio*"), "the Supreme Court took the formal step to incorporate *Blasius* 'within *Unocal*,' " holding that "when directors are faced with a threat to corporate control and act with the primary purpose to thwart the stockholders' franchise rights, the *Blasius* 'compelling justification' test must be met before the Court will apply the reasonableness and proportionality test of *Unocal* . . . to the board's defensive actions."

Following *Liquid Audio*, however, Delaware courts were left with "the practical problem of how to turn *Unocal*'s reasonableness review and *Blasius*' 'primary purpose' and 'compelling justification' elements into a useful standard of review." In fact, *Blasius* "turned out to

be unworkable in practice," with "the outcome . . . for the most part, preordained."

B. Application of Unocal Analysis to Stock Sale challenge

After discussing several subsequent Chancery Court decisions applying some combination of *Schnell*, *Blasius*, and *Unocal* in the context of directorial actions impacting "the stockholder franchise or the result of director elections," the *Coster IV* Court proclaimed—seemingly in response to Chancellor McCormick's concerns articlulated in *Coster III*—that "[e]xperience has shown that *Schnell* and *Blasius* review, as a matter of precedent and practice, have been and can be folded into *Unocal* review to accomplish the same ends-enhanced judicial scrutiny of board action that interferes with a corporate election or a stockholder's voting rights in contests for control." Specifically,

- "When *Unocal* is applied in this context, it can 'subsume[] the question of loyalty that pervades all fiduciary duty cases, which is whether the directors have acted for proper reasons' and 'thus address[] issues of good faith such as were at stake in *Schnell*.' "
- "*Unocal* can also be applied with the sensitivity *Blasius* review brings to protect the fundamental interests at stake—the free exercise of the stockholder vote as an essential element of corporate democracy."

Against this backdrop, the *Coster IV* Court explained that "[w]hen a stockholder challenges board action that interferes with the election of directors or a stockholder vote in a contest for corporate control, the board bears the burden" of proving two key elements reminiscent of *Unocal*. *First*, "whether the board faced a threat 'to an important corporate interest or to the achievement of a significant corporate benefit." And *second*, "whether the board's response . . . was reasonable in relation to the threat posed and was not preclusive or coercive to the stockholder franchise." With regard to the *first prong*, echoing *Schnell*, "[t]he threat must be real and not pretextual," "the board's motivations must be proper and not selfish or disloyal," and "the threat cannot be justified on the grounds that the board knows what is in the best interests of the stockholders." With regard to the *second prong*, echoing *Blasius*, the board "must tailor its response to only what is necessary to counter the threat" and its "response . . . cannot deprive the stockholders of a vote or coerce the stockholders to vote a particular way."

Finally, turning to the controversy at hand—the sustainability of the Stock Sale—the *Coster IV* Court explained that "[a]pplying *Unocal* review . . . with sensitivity to the stockholder franchise is no stretch

for our law." That was, in fact, what the *Coster IV* Court perceived Chancellor McCormick undertook and accomplished (albeit not in so many words) in *Coster III*:

- With respect to the first *Unocal* prong, the Chancellor concluded on remand, "that the UIP Board faced a threat . . . described as an 'existential crisis' . . . to UIP's existence through a deadlocked stockholder vote and the risk of custodian appointment." "[O]n balance," the Chancellor concluded "the board was properly motivated in responding to the threat" and "acted in good faith 'to advance the best interests of UIP . . . .'" Therefore, *Schnell* was not implicated.
- With respect to the second *Unocal* prong, for the many reasons enumerated by the Chancellor in *Coster III* supporting her conclusion there was a compelling justification under *Blasius* for the Stock Sale, not only did the Board "responded reasonably and proportionately to the threat posed," but under the "exceptionally unique circumstances," the Stock Sale "was appropriately tailored" and neither "preclusive [n]or coercive."

CONCLUSION

The back and forth between Chancellor McCormick and the Supreme Court in the *Coster Decisions* offers a fascinating commentary on the relationship among various standards of review employed by Delaware courts when addressing directorial breach of fiduciary duty claims. No less an authority than the Chancellor characterized the "facts and law" of the *Coster Decisions* as "vexingly complicated or unique."

Of course, as in all Delaware corporate jurisprudence, the context of the *Coster Decisions* is important: a board of directors issued stock to an interested party for the purpose of blocking a fifty-percent stockholder from taking actions the board believed were detrimental to the corporation. It is by no means newsworthy to note that, as the *Coster II* Court observed, Delaware courts "closely scrutinize" board actions that "imped[e] stockholders' franchise rights" or otherwise "impede a stockholder's exercise of a statutory right relating to the election of directors." This close scrutiny is how Delaware courts have long justified the broad delegation of authority to corporate boards under § 141(a) of the Delaware General Corporation Law.

After the *Coster II* Court rejected her exclusive reliance on the entire fairness standard of review and directed her, on remand, to

conduct a *Schnell*/*Blasius* analysis, in *Coster III* Chancellor McCormick was critical of *Schnell* as a standard of review and approached the *Blasius* analysis with particular care. In this connection, the Chancellor adopted a "limited" application of *Schnell*, requiring that "directors have *no good faith basis* for approving the disenfranchising action" (emphasis added) before invoking *Schnell*. Moreover, while recognizing that "to date this court has found compelling justifications under *Blasius* in limited circumstances," the Chancellor found "the exceptionally unique circumstances" before her warranted a finding that "[d]efendants have met the onerous burden of demonstrating a compelling justification." On this basis, Chancellor McCormick reached the same ultimate conclusion as she had in *Coster I*: the Stock Sale would stand.

Perhaps in response to the critique leveled by Chancellor McCormick in *Coster III*, or at least to alleviate her concerns, the *Coster IV* Court, without abandoning either *Schnell* or *Blasius*, adopted a familiar *Unocal*-based framework for analyzing stockholder challenges to board actions that limit or impede stockholder voting rights in the context of a contested election of directors. Nothing revolutionary here. Instead, the *Coster IV* Court acknowledged what the Supreme Court had instructed in the past: neither *Schnell* nor *Blasius* need be applied in a vacuum or in competition with the other. Rather, they can be "folded into *Unocal* review to accomplish the same ends—enhanced judicial scrutiny of board action that interferes with a corporate election or a stockholder's voting rights in contests for control."

Against this backdrop, the *Coster IV* Court fully supported the Chancellor's approach in *Coster III*. In fact, *Coster IV* analyzed the Chancellor's findings under the rubric of the two-pronged *Unocal* analysis, both in terms of the perceived "existential" threat to the Company and the Board's reasonable and proportionate response. While the bar for judicial approval of measures taken by a corporate board to limit or impede stockholder voting rights remains a high one, *Coster IV* provides a familiar framework that seeks to address the uncertainty with the *Schnell*/*Blasius* approach confronted by Chancellor McCormick. It will be interesting, going forward, to see how the Chancery Court applies the *Unocal*-driven approach of *Coster IV*.