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First Union v. SunTrust and The Delaware Experience: An Analysis of Deal Protection Measures

In August 2001, the North Carolina Business Court ("NCBC") entered a judgment that dealt a fatal blow to SunTrust's attempted breakup of the First Union-Wachovia merger.[1] SunTrust had urged the NCBC to dispense with the lockout provision[2] and termination fee[3] in the First Union-Wachovia merger agreement. The NCBC granted half of SunTrust's request by discarding the lockout provision, while upholding the termination fee.[4]

The NCBC, lacking North Carolina precedent,[5] struggled to develop an appropriate standard of review for deal protection provisions and turned to Delaware for guidance. After an extensive

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1. First Union Corp. v. SunTrust Banks, Inc., No. 01-CVS-10075 (N.C. Bus. Ct. Aug. 10, 2001), *at* http://www.ncbusinesscourt.net/opinions/2001%20NCBC%2009A.pdf (last visited May 6, 2002) (on file with the North Carolina Law Review). On a number of occasions prior to December 2000, SunTrust and Wachovia had explored the possibility of entering into a business combination. *Id.* ¶ 92. Wachovia chose not to pursue a combination with SunTrust, instead opting to bargain with First Union. *Id.* ¶¶ 100–03. During the first half of 2001, First Union and Wachovia entered negotiations, leading to a formal merger agreement. *Id.* ¶¶ 104–18. On May 14, 2001, SunTrust publicly announced its unsolicited proposal to acquire Wachovia. *Id.* ¶ 119. Thereafter, First Union and SunTrust disputed two of the deal protection provisions in the First Union-Wachovia merger agreement in the North Carolina Business Court. *Id.* ¶ 123.

2. Under a lockout provision (or non-termination provision) the target agrees not to merge with a third party for a significant period of time notwithstanding a negative shareholder vote. *See* ARTHUR FLEISCHER, JR. & ALEXANDER R. SUSSMAN, TAKEOVER DEFENSE 15-79 (6th ed. 2002). The lockout provision in the First Union-Wachovia merger agreement provided that the merger agreement would remain in place until January 2002, even if it was rejected by the Wachovia shareholders at the scheduled August 3, 2001 shareholder meeting. *First Union*, No. 01-CVS-10075, ¶ 3.

3. A termination fee (or breakup fee) is a payment that must be made by one party to the other if certain triggering events occur. *See* FLEISCHER & SUSSMAN, *supra* note 2, at 15-90 to 15-91. A very common trigger is the failure of shareholders to approve the merger. *Id.* Although the termination fee in the First Union-Wachovia merger agreement was based on a complicated financial structure, it would require Wachovia to pay $780 million, or 6% of the total transaction value, if the merger was not consummated. *First Union*, No. 01-CVS-10075, ¶¶ 3, 143.

4. On August 3, 2001, Wachovia shareholders voted to approve the merger with First Union. An estimated 55% to 60% of the 203 million Wachovia shares outstanding were voted in approval. Carrick Mollenkamp, *First Union and Wachovia Shift Focus to Merging*, WALL ST. J., Aug. 6, 2001, at A3.

5. The appellate courts in North Carolina have not had the opportunity to address issues involving the appropriate balance between shareholder power and board authority in corporate mergers. *First Union*, No. 01-CVS-10075, ¶ 2.

review of Delaware case law addressing the subject,[6] the NCBC concluded that "refocus[ing] on the relationship between shareholder rights and directors [sic] duty to make informed decisions in good faith would be more helpful."[7] The NCBC then promulgated North Carolina's standard of review for deal protection provisions, stating,

> the action of the directors is entitled to a strong presumption of reasonableness and validity, including noncoercion, and the court should not intervene unless the shareholder can rebut that presumption by clear and convincing evidence that the deal protection provisions were actionably coercive, or that the deal protection provisions prevented the directors from performing their statutory duties.[8]

The standard of review developed by the NCBC is an oversimplification of the realities surrounding deal protection provisions and creates an unworkable standard. For example, Delaware has suggested at least three different standards of review depending on the circumstances surrounding the deal protection provisions.[9] The decision also does not adequately define a board's fiduciary duty in the context of corporate mergers, an area void of North Carolina case law.[10] This Recent Development highlights the weakness of the NCBC's standard of review and attempts to extract a definition of a North Carolina board's fiduciary duty from the *First Union* decision. Moreover, this Recent Development suggests how the NCBC would have decided the case had it used a more robust standard of review, been more cognizant of the process used by First Union and Wachovia's boards in arranging the transaction, and been more careful with its use of non-North Carolina decisions, which it used as persuasive precedent.

Taken as a whole, Delaware law addressing deal protection provisions is in a state of flux.[11] Despite this current unrest, the history of Delaware deal protection law dates back to the early 1980s, when Delaware courts were forced to "choose between two competing models as to how corporation law should address contests

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6. For an overview of Delaware standards of review and deal protection provisions, see generally William T. Allen et al., *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287 (2001); Leo E. Strine, Jr., *Categorical Confusion: Deal Protection Measures in Stock-for-Stock Merger Agreements*, 56 BUS. LAW. 919 (2001).

7. *First Union*, No. 01-CVS-10075, ¶ 62.

8. *Id.* ¶ 70.

9. *See infra* notes 15–30 and accompanying text.

10. *See supra* note 5.

11. *See* Allen, *supra* note 6, at 1292; Strine, *supra* note 6, at 920, 923, 926–27.

for corporate control."[12] Decisions indicate that the director-centered, as opposed to the shareholder-centered, model won out.[13] The Delaware Chancery Court, however, has increasingly been leaning more towards shareholder rights.[14] More importantly, within Delaware at least three standards of review exist for deal protection provisions, depending on the surrounding circumstances.[15] The traditional business judgment rule, the oldest and most lenient standard of review, states that boards' decisions are presumed valid unless a plaintiff meets its burden in proving that a board has violated its duty of care or loyalty.[16] Under the enhanced scrutiny standard, courts review both the board's decisionmaking process and the board's final action.[17]

Enhanced scrutiny applies in two situations: (1) when a board "adopts a defensive mechanism in response to an alleged threat to corporate control or policy" (*Unocal*); or (2) in the context of a transaction involving a sale of control and/or break-up of the company (*Revlon*).[18] When a board implements anti-takeover measures, there arises "the omnipresent specter that a board may be acting primarily in its own interests [management entrenchment], rather than those of the corporation and its shareholders."[19] Because of this potential conflict of interest, the first level of enhanced scrutiny review, known as *Unocal* review, imposes a special burden on directors prior to their enjoyment of the benefits of the business judgment rule.[20] Under *Unocal*, the board has the burden to establish that (1) it reasonably perceived that the unsolicited takeover bid was

12. Strine, *supra* note 6, at 925.

13. *See* Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1154–55 (Del. 1989) (declining to hold that directors must abandon a deliberately conceived corporate plan); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1357 (Del. 1985) (sanctioning the poison pill); Strine, *supra* note 6, at 925.

14. *See* Quickturn Design Sys., Inc. v. Shapiro, 721 A.2d 1281, 1292–93 (Del. 1998) (holding a slow-hand pill adopted by the board invalid); Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34, 36 (Del. 1994) (enjoining Paramount from proceeding with measures that would operate to discourage competing bidders); Robin Sidel, *Leo Strine Issues Rulings, and Entertains His Audiences, as Judge on Takeover Cases*, WALL ST. J., June 26, 2001, at C1.

15. Edward D. Herlihy, *Takeover Law and Practice 2001*, *in* CONTESTS FOR CORPORATE CONTROL 285, 299–307 (Dennis J. Block chair, 2002).

16. *Id.* at 300. To demonstrate that a board has violated its duty of care, a plaintiff must prove that directorial conduct has risen to the level of "gross negligence." *Id.* To show that a board has violated its duty of loyalty, a plaintiff must prove that members of the board engaged in "self-dealing" transactions. *Id.* at 301.

17. *Id.* at 302.

18. *Id.* at 302.

19. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985).

20. *See id.*

a threat to corporate effectiveness and policy, and (2) the defensive measure adopted was reasonable in response to the threat.[21] A court will find a defensive measure to be disproportionate to the threat if it is either draconian (preclusive or coercive) or if it falls outside a range of reasonable responses.[22] A defensive measure is coercive when it operates to force management's preferred alternative upon the stockholders.[23] Board actions are preclusive only if they make alternate transactions "mathematically impossible or realistically unattainable," not if they simply discourage other bids.[24]

The second level of enhanced scrutiny review, known as *Revlon* review, is more restrictive to ensure that a board's sole objective is maximizing shareholder value.[25] When *Revlon* applies, the whole question of defensive provisions becomes moot.[26] In *Paramount Communications, Inc. v. Time, Inc.*,[27] the Delaware Supreme Court described two situations which implicate *Revlon* duties: first, "when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company," and second, "where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the breakup of the company."[28] When Delaware courts find an actual conflict of interest that affects a majority of the directors approving a transaction, they apply the most exacting standard, entire fairness review, by determining whether a transaction is entirely fair to stockholders.[29] Conflicts of interest may arise when directors sit on the boards of both parties to a transaction, or acquire pecuniary gain from a transaction that is not extended to the corporation or its shareholders.[30]

The NCBC's failure to develop a standard of review that echoes Delaware courts' consideration of whether a deal protection provision arises as a pro-active measure or a defensive measure, or whether the transaction involves a change of control or conflict of

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21. *See id.* at 955.
22. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 1367 (Del. 1995).
23. *See In re* Gaylord Container S'holders Litig., 753 A.2d 462, 484–85 (Del. Ch. 2000).
24. *Unitrin*, 651 A.2d at 1389.
25. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986).
26. *See id.*
27. 571 A.2d 1140 (Del. 1989).
28. *Id.* at 1150.
29. Herlihy, *supra* note 15, at 304; *see* Williams v. Geier, 671 A.2d 1368, 1384–85 (Del. 1996).
30. Herlihy, *supra* note 15, at 304.

interest, is problematic. The court fails to establish a tri-leveled test, grounded in the business judgment rule with increasing levels of scrutiny applied as the potential for director conflict of interest increases. Instead the review is a catch-all standard, derived in part from a comment made in a recent article by Delaware Vice Chancellor Leo E. Strine, Jr.[31] and from the NCBC's interpretation of section 55-8-30(d) of the General Statutes of North Carolina,[32] that essentially finds invalid any coercive deal protection provision.[33] Strine does not suggest supplanting Delaware law with such a coercive test. Rather, his article advocates an approach that focuses on uncoerced shareholder choice as a practical way to balance shareholder and director interests.[34] Indeed, Strine suggests that the standards of review developed in Delaware are still applicable.[35] The court utilizes his article as a summary of Delaware case law, though it is only an "explor[ation of] some of the doctrinal tensions posed by deal protection measures."[36] Building a catch-all standard of review from this comment misinterprets Strine and neglects the decades of deal protection case law in Delaware.

Because North Carolina has not previously developed a standard for reviewing a board's fiduciary duty in the context of corporate mergers,[37] this decision provides the only definition of the North Carolina duty. In its discussion of the influence of recently amended North Carolina General Statute section 55-8-30(d),[38] the NCBC indicated that the business judgment rule has been the common law rule in North Carolina.[39] The NCBC concluded that the amendment

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31. Strine, *supra* note 6, at 941.

32. Section 55-8-30 was amended by the addition of subsection (d). Act of July 24, 1993, ch. 552, § 11, 1993 N.C. Sess. Laws 2912, 2917. "The duties of a director weighing a change of control situation shall not be any different, nor the standard of care any higher, than otherwise provided in this section." N.C. GEN. STAT. § 55-8-30(d) (2002) (amended 1993).

33. *See* First Union Corp. v. SunTrust Banks, Inc., No. 01-CVS-10075, ¶ 67–70 (N.C. Bus. Ct. Aug. 10, 2001), *at* http://www.ncbusinesscourt.net/opinions/2001%20NCBC%2009A.pdf (last visited May 6, 2002) (on file with the North Carolina Law Review).

34. *See* Strine, *supra* note 6, at 941.

35. *See* Allen, *supra* note 6, at 1319 (urging that the *Unocal* intermediate standard should continue to govern all objectively defensive actions taken by boards of directors); *id.* at 1320 (suggesting that the current *Unocal/Unitrin* "standard's focus on preclusion and coercion is functionally useful and should be retained").

36. Strine, *supra* note 6, at 920.

37. *See supra* note 5 and accompanying text.

38. *See First Union*, No. 01-CVS-10075, ¶¶ 69–70.

39. *See id.* ¶ 69 n.111 (citing State *ex rel.* Long v. ILA Corp., 132 N.C. App. 587, 601, 513 S.E.2d 812, 821 (1999)); *see also* Winters v. First Union Corp., No. 01-CVS-5362, ¶ 15 (N.C. Bus. Ct. July 13, 2001), *at* http://www.ncbusinesscourt.net/opinions/2001%20NCBC%2008.htm (last visited May 6, 2002) (on file with the North Carolina Law Review) (citing

was directed at *Revlon*, and not at the *Unocal* standard of review.[40] Without explicitly stating so, the NCBC assumed that it is appropriate to have a *Unocal*-type standard of review[41] regardless of the context of a deal protection provision, despite just previously citing to a North Carolina decision supporting the business judgment rule. The NCBC failed to entertain two alternative methods of applying the statute. First, it might have followed the statute and North Carolina precedent by simply applying the business judgment rule. Second, considering the NCBC's willingness to bend the statute in order to invoke a higher level of review, the NCBC might have adopted the Delaware tri-level review.

The NCBC's coercive test thus originates from a misconstruction of Vice Chancellor Strine's article and a disregard of North Carolina precedent which could have been avoided through an alternate statutory construction of section 55-8-30(d). When compared to Delaware, North Carolina appears to have both a stricter and more lenient duty, depending on the circumstances. For example, in a situation where Delaware would apply the traditional business judgment rule, North Carolina would appear to impose a stricter duty, i.e., its coercive test, which is based on the *Unocal* test.[42] However, in a situation where Delaware would apply the entire fairness review, North Carolina would appear to impose a more lenient duty by again applying the *Unocal* based coercive test.[43] Although several states have enacted statutes similar to section 55-8-30(d) to prevent their courts from adopting stricter modes of review (e.g., from the traditional business judgment rule to Delaware's enhanced scrutiny and entire fairness reviews),[44] no state has

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Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1142 (Del. 1989)) (applying North Carolina law and holding that "the decision to enter into a merger agreement is a decision for the board of directors that is subject to review under the business judgment rule"). Under the business judgment rule, the decision of a "loyal and informed board will not be overturned by a court unless it cannot be attributed to any rational business purpose." *Long*, 132 N.C. App. at 602, 513 S.E.2d at 822 (citing RUSSELL M. ROBINSON II, ROBINSON ON NORTH CAROLINA CORPORATION LAW § 14.6 (5th ed. 1995)).

40. *First Union*, No. 01-CVS-10075, ¶ 70.

41. The NCBC finds support for this contention in its interpretation of Vice Chancellor Strine's article. *See supra* notes 31–36 and accompanying text.

42. *See First Union*, No. 01-CVS-10075, ¶ 70.

43. *See id.* North Carolina's standard does not contain a preclusive component, which is included in Delaware's first level of enhanced scrutiny (which is the most lenient among Delaware's first level of enhanced scrutiny (*Unocal*), second level of scrutiny (*Revlon*), and entire fairness standards).

44. Several states reject Delaware's deal protection provisions, thereby relying solely on the business judgment rule, which gives directors more flexibility, greater freedom-of-contract, and the ability to weigh factors other than shareholder value. John J. Jenkins,

developed a body of law that is both less restrictive and more restrictive than Delaware.

Adding to the confusion, the NCBC uses as persuasive precedent individual Delaware cases[45] applying different tiers of review to justify the *Unocal* tier it universally adopts. Because the NCBC failed to flesh out the entire tri-leveled Delaware test, the NCBC's standard of review will lead to results contrary to those in Delaware, despite its "reliance" upon Delaware cases. North Carolina's test is not a sophisticated, situation-specific, tri-leveled method of analyzing deal protection provisions, and it therefore fails to enable North Carolina courts to vary their level of review as the potential director conflict of interest varies. North Carolina would be better served had the NCBC followed Delaware's lead. The NCBC's coercive test will allow self-interested transactions that Delaware would invalidate under *Revlon* review, and thus fails to adequately protect shareholders. It will also possibly invalidate mere business decisions that Delaware would uphold under the business judgment rule. The NCBC makes a functional error in looking to Delaware for precedent and failing to accurately apply the case law, and makes a substantive error in failing to establish tri-leveled review, which is the better test.

Although the NCBC did not attempt to determine the standard of review that Delaware would have applied, the strong analogy between *First Union* and *Paramount Communications, Inc. v. Time Inc.*[46] suggests that *First Union* should be subject to the traditional business judgment rule.[47] Absent unusual circumstances, a board's careful, deliberative, and thorough review process triggers the traditional business judgment rule review. In *Time*, the Delaware court upheld the deal protection provisions despite their severity

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What's the Big Deal?, BUS. L. TODAY, Nov./Dec. 2000, at 32, 36 (stating that several large states, including Indiana, Maryland, New Jersey, Ohio, and Pennsylvania, have refused Delaware's approach to deal protections by adopting anti-*Unocal* statutes). Likewise, many directors shun Delaware's focus on shareholders at the expense of director and other stakeholder interests. *E.g.*, BRYAN BURROUGH & JOHN HELYAR, BARBARIANS AT THE GATE vii (Harper & Row 1990) (quoting Adolphus Green, founder of Nabisco: "The officer of every corporation should feel in his heart—in his very soul—that he is responsible, not merely to make dividends for the stockholders of his company, but to enhance the general prosperity and the moral sentiment of the United States.").

45. *See infra* notes 46–49 and 65–80 and accompanying text.

46. 571 A.2d 1140 (Del. 1989).

47. *See id.* at 1152 (applying business judgment rule to decision to enter into Time-Warner merger transaction); *id.* at 1142 (stating that there is no duty to negotiate with a third party in the context of a strategic merger); *id.* at 1152 ("We have repeatedly stated that the refusal [of directors] to entertain an offer may comport with the valid exercise of a board's business judgment.").

because it found that the Time board had entered into the merger agreement with Warner after a careful, deliberative, and thorough process.[48] Specifically, the Time board carefully considered strategic combinations over more than a year and held informal discussions with several companies.[49] It considered and rejected Paramount as a potential merger partner.[50] After a rigorous process, the Time board concluded that a combination with Warner was likely to lead to the best long-term value for shareholders and therefore entered into a merger agreement with Warner.[51] The Time deal protection provisions were extensive and included a lock-up agreement,[52] a no-shop provision preventing Time from considering any other consolidation proposal, and "dry-up" agreements pursuant to which Time paid various institutions to not finance a hostile bid against it.[53] Most significantly, the court held that despite its potential interference with shareholder value, Time was allowed to prevent a shareholder vote entirely by switching to a cash deal.[54]

First Union bears striking similarities to *Time*. First Union and Wachovia entered into their merger agreement after a careful, deliberative, and thorough process, just as the parties in *Time* did, suggesting that *Time* should apply.[55] Additionally, because the termination fee and lockout agreement in *First Union* were less severe than removing a shareholder vote entirely, as occurred in

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48. *Id.* at 1154–55.

49. *Id.* at 1154.

50. *Id.*

51. *Id.*

52. Lock-up fees are a type of termination fee. *E.g.*, Stephen R. Volk et al., *Negotiating Business Combination Agreements—The "Sellers" Point of View*, 33 SAN DIEGO L. REV. 1077, 1110–11 (1996) ("Break-up fees and lock-up stock options make it more expensive for a third party to compete with the original acquiror. The third party not only must pay the stockholders for their shares, but also must bear the cost of the transaction protection devices."); *see also supra* note 3.

53. *Time*, 571 A.2d at 1146.

54. *Id.* at 1148.

55. *See* First Union Corp. v. SunTrust Banks, Inc., No. 01-CVS-10075, ¶ 130–41 (N.C. Bus. Ct. Aug. 10, 2001), *at* http://www.ncbusinesscourt.net/opinions/2001%20NCBC%2009A.pdf (last visited May 6, 2002) (on file with the North Carolina Law Review). "[The Wachovia board's] selection of First Union as a merger partner was consistent with a thoroughly studied and well-conceived business strategy ...." *Id.* ¶ 132. "This was an informed, independent, fully functional, intelligent, engaged and knowledgeable board." *Id.* ¶ 133. "[The board] was under no duty to structure its merger proposal with First Union to permit an interloping bid from SunTrust." *Id.* ¶ 135. "[The board] properly relied on their advisors and they understood and made the key decision with sufficient knowledge and understanding." *Id.* ¶ 141. "[The board] had studied other strategic merger possibilities and determined this was the best." *Id.*

Time, the provisions in *First Union* should have been permitted under the traditional business judgment rule standard.

The NCBC's decision includes other examples where it was hasty in both its use and disregard of non-North Carolina cases as persuasive precedent. For example, although the court noted that "resort[ing] to prior decisions ... [may] provide help in its legal analysis of coercion,"[56] it failed to apply a case that was especially on point. In *Phelps Dodge Corp. v. Cyprus Amax Minerals Co.*,[57] the Delaware Chancery court indicated in dictum that a 6.3% termination fee in a merger agreement that included a no-talk provision would likely be coercive under *Unocal*'s enhanced scrutiny review.[58] Though its statement is not precedent, the Delaware Chancery Court would likely find its own dictum persuasive. Considering the fact that the First Union-Wachovia merger agreement contained provisions similarly restrictive to termination fees and no-talk provisions, it follows that the termination fee in First Union-Wachovia's agreement would have been deemed coercive under *Unocal*.[59] Consequently, the First-Union Wachovia termination fee, at a level of 6%, should have been rejected under North Carolina's coercive test.[60] Also, the general understanding that 1–5% is the permissible range of termination fees for Delaware, with larger transactions typically falling on the lower side of this range,[61] provides additional support for rejecting the termination provision. In other words, if the NCBC looks to Delaware to determine what is coercive (as it claimed to do and arguably should have done), then the termination provision was coercive and thus under the coercive test the court developed, it should have been rejected.[62] The court's failure to reject the termination provision is inconsistent with either its claim to rely on Delaware law or with the test it developed itself.

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56. *See id.* ¶ 85.

57. C.A. No. 17398, 1999 Del. Ch. LEXIS 202 (Del. Ch. Sept. 27, 1999).

58. *See id.* at *2 (noting that a 6.3% termination fee appears unreasonable).

59. The First Union-Wachovia merger agreement contained a lockout provision and a termination fee. *See supra* notes 2–3 and accompanying text.

60. Although Delaware precedent suggests that a termination fee should be rejected at this level, another possibility suggested by some Delaware judges is to reduce the termination fee. *See* Strine, *supra* note 6, at 941 n.71.

61. Charles M. Nathan, *Deal Defense*, THE DEAL, June 21, 2001, *available at* http://208.185.43.170/NASApp/cs/ContentServer?pagename=TheDeal/TDDArticle/StandardArticle&c=TDDArticle&cid=1003865097537 (last visited May 6, 2002) (on file with the North Carolina Law Review); *see also* Matador Capital Mgmt. Corp. v. BRC Holdings, Inc., 729 A.2d 280, 291 (Del. Ch. 1998).

62. *See supra* text accompanying notes 31–45.

The NCBC also neglected relevant case law in the context of analyzing *First Union*'s six month lockout provision. The NCBC's statement that "[t]his court is not aware of any judicial blessing of non-termination clauses similar to this one"[63] overlooks *CSX Corp. v. Norfolk Southern Corp.*,[64] a case which included a judicial blessing of a non-termination clause involving an eight month and a two year lockout. The district court applied the traditional business judgment rule under Pennsylvania law and concluded that the eight month lockout was not coercive.[65] Likewise, the district court denied Norfolk's request for a preliminary injunction against enforcement of the two year lockout.[66]

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63. First Union Corp. v. SunTrust Banks, No. 01-CVS-10075, ¶ 159 (N.C. Bus. Ct. Aug. 10, 2001), *at* http://www.ncbusinesscourt.net/opinions/2001%20NCBC%2009A.pdf (last visited May 6, 2002) (on file with the North Carolina Law Review).

64. The litigation among Conrail, CSX, and NS ultimately involved three preliminary injunction hearings in the United States District Court for the Eastern District of Pennsylvania, a motion before that court for a temporary restraining order, and two oral arguments before the Third Circuit Court of Appeals. The case produced a number of opinions. *See* Karen L. Valihura & Leonard P. Stark, *Fiduciary Duties Derailed? Appropriation of Directors' Duties in the Battle for Control of Conrail*, 24 J. CORP. LAW 29, 32 n.12 (1998) (citing Preliminary Injunction Hearing Transcript, Norfolk S. Corp. v. Conrail, Inc., C.A. No. 96-7167, at 596 (E.D. Pa. Nov. 19, 1996) (bench ruling) (denying preliminary injunction to enjoin first step of CSX's tender offer for 19.9% of Conrail's shares) [hereinafter November Preliminary Injunction Hearing Transcript]; Preliminary Injunction Hearing Transcript, Norfolk S. Corp. v. Conrail, Inc., C.A. No. 96-7167 (E.D. Pa. Dec. 17, 1996) (bench ruling) (enjoining Conrail from indefinitely delaying shareholder vote on charter amendment); Preliminary Injunction Hearing Transcript, Norfolk S. Corp. v. Conrail, Inc., C.A. No. 96-7167 (E.D. Pa. Jan 9, 1997) (bench ruling) (denying preliminary injunction motion based on fiduciary duty breach in 720-day lockout and on contention that control transaction had already occurred) [hereinafter January Preliminary Injunction Hearing Transcript]; Norfolk S. Corp. v. Ferrara, 111 F.3d 127 (3rd Cir. 1997) (affirming district court's denial of preliminary injunctions in November and January)). *See generally* Vincent F. Garrity, Jr. & Mark A. Morton, *Would the CSX/Conrail Express Have Derailed in Delaware? A Comparative Analysis of Lock-Up Provisions Under Delaware and Pennsylvania Law*, 51 U. MIAMI L. REV. 677 (1997) (examining whether the Delaware courts would have reached the same conclusion concerning the adoption and use of the "lock-up" provisions if the litigation had been filed in the Delaware Court of Chancery and Conrail had been a Delaware, rather than a Pennsylvania, corporation, and concluding that it is likely that the Delaware courts, unlike the district court, would have invalidated some or all of the provisions employed by Conrail and CSX); Comment, *The Sale of Conrail: Pennsylvania's Anti-Takeover Statutes versus Shareholder Interests*, 72 TUL. L. REV. 1369 (1998) (exploring the efficacy of the Pennsylvania Business Corporation Law's anti-takeover provisions and the legacies of the Conrail deal).

65. *See* Garrity & Morton, *supra* note 64, at 689 (citing November Preliminary Injunction Hearing Transcript, *supra* note 64, at 652). The court found no coercion, "but only several options, any of which will undoubtedly end up being a net return to most shareholders far in excess of whatever their original investment may have been." *Id.*

66. *See id.* (citing January Preliminary Injunction Hearing Transcript, *supra* note 64, at 161).

Rather than applying *CSX*, the NCBC analogized the *First Union* merger to *Quickturn Design Systems, Inc. v. Shapiro*.[67] The NCBC's reliance on *Quickturn* to support its rejection of the lockout provision seems misplaced for several reasons.[68] In *Quickturn*, the board adopted a slow-hand provision[69] that was unredeemable for six months by a newly elected board.[70] The Delaware Supreme Court held the slow-hand provision invalid because it "impermissibly deprive[d] any newly elected board" of its authority to manage the corporation.[71] The fundamental principle at issue in *Quickturn*, that shareholders have the ultimate right to elect directors who will do their bidding, was not at issue in *First Union*.[72] *First Union*, instead of dealing with a potential abrogation of shareholder power to elect empowered directors, dealt with a board decision to enter a contractual deal protection provision.[73] Shareholder concerns regarding the method by which their directors will bid, which may include deal protection provisions, must be taken into account when electing directors. *Quickturn* protects shareholders' ability to steer the board's bidding process solely by protecting shareholders' voting rights. It does not support interfering with contractual deal protection provisions employed by rightfully elected directors. Another distinction stems from the fact that *Quickturn* arose in the context of an existing battle,[74] invoking *Unocal*, whereas *First Union* involved a pro-active agreement,[75] invoking *Time* or the traditional business judgment rule.

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67. 721 A.2d 1281 (Del. 1998).

68. The NCBC made an analogy between the *Quickturn* no-hand provision and the lockout arrangement as part of its reasoning for rejecting the lockout arrangement. *First Union*, No. 01-CVS-10075, ¶ 157.

69. A slow-hand provision (or no-hand provision) suspends, limits, or eliminates the board's ability to redeem a poison pill once a majority of the board has been replaced. FLEISCHER & SUSSMAN, *supra* note 2, at 5-7. A poison pill (or rights plan) is generally a right to buy shares in the merged firm at a bargain price. *Id.* at 5-102. The right is granted to the firm's shareholders, contingent on another firm acquiring control. *Id.* The right dilutes the stock such that the bidding firm loses money on its shares. *Id.*

70. *Quickturn Design Sys.*, 721 A.2d at 1288.

71. *Id.* at 1291.

72. *See id.* at 1291–92. "*Quickturn* focuses on the features of the slow hand pill itself, *not* the identity of the actor that implemented the provision." John C. Coates IV & Bradley C. Faris, *Second-Generation Shareholder Bylaws: Post-*Quickturn *Alternatives*, 56 BUS. LAW. 1323, 1331 (2001). "*Quickturn* should thus not be read to encompass all types of corporate bylaws and contracts." *Id.* at 1331.

73. *See First Union*, No. 01-CVS-10075, ¶ 156.

74. *See Quickturn Design Sys.*, 721 A.2d at 1287.

75. *See First Union*, No. 01-CVS-10075, ¶ 130–41.

Finally, the NCBC's use of *Paramount Communications, Inc. v. QVC Network Inc.*[76] failed to adequately distinguish *QVC* from *First Union*. The NCBC cited *QVC* to support two statements: (1) "Thus, the [Delaware] court made clear that a board's fiduciary obligations supercede their right to enter into contracts on behalf of the corporation."[77] (2) "At each turn, the Delaware Courts have invalidated plans that purport to restrict a board's duty to fully protect the interests of the corporation and its shareholders."[78] *QVC* involved reactive provisions in the midst of a battle (which would trigger at least *Unocal*, but in fact triggered *Revlon*[79] because it involved a change of control)[80] rather than provisions put in place consistent with a long-term plan as in *Time* and *First Union*.[81] Also, by holding that *Revlon* is still good law, *QVC* did not overrule *Time*.[82]

Considering the close nature of the Wachovia shareholder vote,[83] the NCBC's decision was likely a material factor in making the First Union-Wachovia merger a reality. Though the NCBC allowed the merger to be completed, its decision oversimplifies the realities surrounding deal protection provisions and fails to establish a tri-leveled system of review, with increasing levels of scrutiny applied as the potential for director conflict of interest increases. In addition to ignoring the complexities surrounding deal protection provisions, the *First Union* decision sets a dangerous precedent by allowing North Carolina courts to use Delaware cases as persuasive precedent without regard to the standard of review applied by Delaware in those cases. Ultimately, the NCBC's test falls short of both protecting shareholders in *Revlon* situations and encouraging legitimate business decisions in the business judgment rule context. A complete reassessment of the NCBC's attempt to balance shareholder power and board authority in corporate mergers is in order.

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76. 637 A.2d 34 (Del. 1994).
77. *First Union*, No. 01-CVS-10075, ¶ 53.
78. *Id.* ¶ 88.
79. *See supra* notes 15–30 and accompanying text.
80. *See* Paramount Communications Inc. v. QVC Network Inc., 637 A.2d 34, 46–48 (Del. 1994).
81. *See* Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1146–47 (Del. 1989); *First Union*, No. 01-CVS-10075, ¶¶ 130–41.
82. *See QVC*, 637 A.2d at 46–48.
83. *See supra* note 4 and accompanying text.