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First Union v. SunTrust Banks: The Fight for Wachovia and Its Impact on North Carolina Corporate Law

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Wachovia Corporation (Wachovia) and First Union Corporation (First Union) merged on September 1, 2001, to form a new company called Wachovia Corporation (new Wachovia).\(^1\) The combination creates the nation's fourth largest commercial banking organization, with consolidated assets of $328.5 billion.\(^2\) However, before the Wachovia/First Union merger could be consummated, Wachovia had to fend off an unsolicited merger proposal by Atlanta-based SunTrust Banks, Inc. (SunTrust), the nation's twelfth largest banking organization.\(^3\) Because contested


2. Order Approving the Merger of Bank Holding Companies, First Union Corporation, Charlotte, North Carolina and Wachovia Corporation, Winston-Salem, North Carolina, 87 Fed. Res. Bull. 683, 684 (Aug. 13, 2001) [hereinafter Fed Order Approving the Merger of First Union and Wachovia]. Prior to the merger, First Union was the sixth largest commercial banking organization in the United States, with total consolidated assets worth $252.9 billion, and controlling approximately 4.1 percent of total banking assets of insured commercial banks in the United States. Id. First Union operated subsidiary banks in Connecticut, Delaware, Florida, Georgia, Maryland, New Jersey, New York, North Carolina, Pennsylvania, South Carolina, Tennessee, Virginia, and Washington, D.C. Id. at 1-2. Respectively, Wachovia was the fifteenth largest commercial banking organization in the United States, with total consolidated assets worth $75.6 billion, and controlling approximately 1.3 percent of total U.S. banking assets. Id. at 2. Wachovia's subsidiary banks operated in Delaware, Florida, Georgia, North Carolina, South Carolina, Tennessee, and Virginia. Id. at 4.

takeover attempts in banking are rare, the well-publicized SunTrust campaign attracted widespread attention. After a proxy battle using full-page newspaper advertisements, Wachovia shareholders approved the negotiated merger with First Union on August 3, 2001, ending one of the most expensive and highly publicized takeover battles in banking history.

The takeover war was fought on three major fronts, including a vigorous publicity campaign by all parties to win shareholder votes, a lobbying campaign by First Union and Wachovia to enlist the North Carolina General Assembly to amend the North Carolina corporate statutes, and a lawsuit filed by SunTrust to revoke the key deal protection clauses in the First Union/Wachovia merger agreement. As a result of the successful lobbying by First Union and Wachovia, North Carolina lawmakers and Governor Mike Easley came to the defense of Wachovia in an effort to fend off SunTrust’s unsolicited merger proposal by passing a bill in June 2001, amending Section 55-7-02(a) of the North Carolina General Statutes. The amended statute limits the

2001) [hereinafter Fed Approval Order of SunTrust Branches]. Asset data are as of September 30, 2001. Id. at 122 n.2.


5. Boraks, This Summer’s Cliffhanger, supra note 1, at 4.


7. See infra notes 83-84 and accompanying text.

8. See infra notes 97-121 and accompanying text.

9. See infra notes 42-49 and accompanying text.

10. 2001 N.C. Sess. Laws 2001-201, § 15 (codified as amended at N.C. GEN. STAT. § 55-7-02(a)(2)) (enacted on June 14, 2001). The new law amends Section 55-7-02(a) of the North Carolina General Statutes to read:

(a) A corporation shall hold a special meeting of shareholders: (1) On call by its board of directors or by one or more officers of the corporation authorized to do so by the articles of incorporation or bylaws or, in the case of a corporation that is not a public corporation, by any other person or persons authorized to do so by the articles of incorporation or the bylaws; or (2) Within 30 days after the holders of at least ten percent (10%) of all the votes entitled to be cast on any issue proposed to be considered at the proposed special meeting sign, date, and deliver to the corporation’s secretary one or more written demands for the
right of shareholders of public corporations to call a special meeting and was intended to prevent SunTrust from using the original provision in a manner First Union believed to be not intended by the legislature. The new law was criticized by some scholars because it protected First Union and Wachovia at the expense of shareholders of public corporations in general.

The takeover battle was also played out in the courts as sixteen lawsuits were filed in federal and state courts in Georgia and North Carolina. In July 2001, the North Carolina Business Court denied SunTrust's motion for a preliminary injunction by upholding a key deal protection measure in the First Union/Wachovia merger agreement. Judge Ben F. Tennille's

meeting describing the purpose or purposes for which it is to be held; except however that, unless otherwise provided in the articles of incorporation, the call of a special meeting by shareholders is not available to the shareholders of a public corporation.


12. Serres, New Law Hurts SunTrust, supra note 10, at D1 (citing Tony Plath, a professor of finance at the University of North Carolina at Charlotte); see also Interview with Thomas L. Hazen, Cary C. Boshamer Distinguished Professor of Law, University of North Carolina at Chapel Hill, in Chapel Hill, N.C. (Oct. 23, 2001) [hereinafter Hazen Interview]. See generally Thomas L. Hazen, Silencing the Shareholders' Voice, 80 N.C. L. REV. (forthcoming Fall 2002) (manuscript at 4-17, on file with N.C. Banking Institute) [hereinafter Hazen, Silencing the Shareholders' Voice].

13. See First Union Proxy Statement/Prospectus, Notice of Shareholder Meeting to Consider the Merger of First Union and Wachovia (dated June 27, 2001), at 171-74 (on file with N.C. Banking Institute) [hereinafter First Union Proxy Statement] (listing sixteen lawsuits relating to the Wachovia/First Union merger filed by June 27, 2001).

sixty-three-page opinion in *First Union Corp. v. SunTrust Banks, Inc.* attracted national attention to the North Carolina Business Court because it was the first time that the court decided to review a merger decision by the board of directors of a public corporation in North Carolina.\(^{15}\)

Part II of this Note introduces the contest for control of Wachovia, including a timeline of major events and significant litigation related to the merger.\(^{16}\) Part III then discusses the proposals of SunTrust and First Union and the roles played by others, including the media, investment banks, and state lawmakers.\(^{17}\) Part IV discusses the controversial law enacted by the North Carolina legislature during the heated contest and its impact.\(^{18}\) In Part VI, this Note examines the North Carolina Business Court decision in *First Union Corp. v. SunTrust Banks, Inc.* and compares the court’s decision to Delaware law.\(^{19}\) Finally, this Note concludes that the merger review process adopted by the North Carolina Business Court is pro-management by putting the burden of proof upon the shareholders when shareholders of a corporation sue the directors for breach of fiduciary duty in a merger context.\(^{20}\)

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\(^{15}\) Chris Serres, *A Clear Winner: The Court*, NEWS & OBSERVER (Raleigh, NC), July 24, 2001, at D1. (stating that after Judge Tennille posted his opinion more than 28,000 people visited the state Business Court website including lawyers as far away as San Mateo, California).

\(^{16}\) *See infra* notes 21-51 and accompanying text.

\(^{17}\) *See infra* notes 52-96 and accompanying text.

\(^{18}\) *See infra* notes 97-121 and accompanying text.

\(^{19}\) *See infra* notes 122-210 and accompanying text.

\(^{20}\) *See infra* notes 217-20 and accompanying text.
II. TIMELINE OF EVENTS

Wachovia, First Union, and SunTrust each have a major presence in banking industry on the East Coast. As of March 2001, Wachovia ranked fourteenth in the nation in terms of total consolidated assets. Wachovia had dual headquarters in Winston-Salem, North Carolina and Atlanta, Georgia. First Union was headquartered in Charlotte, North Carolina and had branches throughout the East coast. Headquartered in Atlanta, Georgia, SunTrust had total assets of $103 billion and branches across six states—Alabama, Florida, Georgia, Maryland, Tennessee and Virginia, as well as the District of Columbia.

As consolidation continued throughout the banking industry, merger talks were common among competing banks. In fact, SunTrust talked with Wachovia about partnering several times during the past decade. Wachovia attracted SunTrust for two major reasons. First, a merger with Wachovia would expand SunTrust's banking network into the demographically desirable Carolinas market where SunTrust does not operate. Second, a

21. See Fed Order Approving the Merger of First Union and Wachovia, supra note 2. Although the transaction to merge Wachovia and First Union completed on September 1, 2001 with the merger of the two principal banking subsidiaries, i.e., First Union National Bank and Wachovia Bank, N.A. will continue to operate separately until the two branch networks are integrated into one. See Wachovia’s website, at http://www.wachovia.com/merger/faqs_next.asp (last visited Feb. 13, 2002). The new company has not announced when it will officially take the name Wachovia. Id. For information on Wachovia’s and First Union’s rankings and assets, see Fed Order Approving the Merger of First Union and Wachovia, supra note 2, at 664 (also listing the states in which they each had subsidiaries). For comparable information on SunTrust, see Fed Approval Order of SunTrust Branches, supra note 3, at 122.

22. First Union Proxy Statement, supra note 13, at 112.
23. Id.
24. Id.
combination with Wachovia would provide SunTrust with Wachovia's strong regional retail brokerage. In December 2000, a merger agreement between SunTrust and Wachovia was drafted, providing a number of “deal protection” devices. However, the merger discussion was abruptly terminated by Wachovia on December 14, 2000, one day before the Wachovia board's scheduled vote on the merger agreement.

In fact, L.M. "Bud" Baker, Jr., Wachovia's Chairman, President and Chief Executive Officer, had been talking with both SunTrust and First Union at the same time, although neither SunTrust nor First Union knew about Mr. Baker's two-track courtship. During late 2000 and early 2001, Baker and First Union CEO G. Kennedy Thompson had further discussions regarding a possible merger between First Union and Wachovia. On April 9, 2001, First Union and Wachovia signed a reciprocal confidentiality agreement. The companies immediately started intensive due diligence reviews of each other's operations and began negotiating on specific terms of the stock-for-stock merger-of-equals. Because of the confidentiality agreement, Baker did not confirm the rumors about a possible merger between Wachovia and First Union when his counterpart at SunTrust called to ask about the rumors.

After the boards of both banks approved the merger agreement, First Union and Wachovia announced the proposed $12.7 billion stock-for-stock merger on April 16, 2001.

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28. Id.
29. First Union Corp. v. SunTrust Banks, Inc., 2001 N.C. Bus. Ct., 01-CVS-10075, ¶ 99. Particularly, a reciprocal option clause of the merger agreement would allow SunTrust or Wachovia to purchase 19.9 % of the other's stock in the event of a merger with a third party. Id. There was no cap on that option and it could be triggered during the eighteen months after the merger agreement was terminated. Id.
30. Id. ¶ 101.
31. Id. ¶ 94.
32. Id. ¶ 104.
33. Id. ¶ 105.
34. Id.
35. Id. ¶ 112.
36. For the reasons why the two boards recommended the merger, see infra notes 54-57 and accompanying text.
37. First Union Corp., 2001 N.C. Bus. Ct., 01-CVS-10075, ¶ 118. As of March 31, 2001, the total purchase price for Wachovia was $13.4 billion. First Union Proxy Statement, supra note 13, at 187. Because the proposed merger was a stock-for-stock...
2001, SunTrust publicly announced its unsolicited $14.7 billion proposal to merge with Wachovia. On May 22, the Wachovia board voted fourteen to one to affirm the First Union merger and to reject the SunTrust offer. On the same day, First Union sued SunTrust in North Carolina Superior Court, alleging that SunTrust interfered with the merger agreement. Wachovia joined the suit the next day, accusing SunTrust of violating a confidentiality agreement signed during their December 2000 merger talks. On May 23, 2001, SunTrust sued Wachovia and First Union in the Georgia Superior Court, seeking an injunction to halt the merger. On June 1, 2001, Wachovia, First Union, and SunTrust agreed that all litigation brought by them would be moved to the North Carolina Business Court. In the consolidated suit, SunTrust asked the North Carolina Business Court to revoke a non-termination provision in the First Union/Wachovia merger agreement. SunTrust also requested the court enjoin consummation of the merger pending determination of the validity of the merger agreement constantly changed as the price of First Union stocks fluctuated. For the dollar amount of the transaction in April 2001, see John Labate, New Twist in Wachovia Fight, FIN TIMES (London), July 21, 2001, at 8. For the value of the merger agreement in August, see First Union Shareholders Approve Wachovia Merger, N.Y. TIMES, Aug. 1, 2001, at C4. Interestingly, it was reported that upon learning of the First Union/Wachovia merger plans, the initial reaction of L. Phillip Humann, chief executive of SunTrust, was “disbelief.” David Boraks, Online Exclusive: An Interview with SunTrust's Humann—“We Had Hope Until the Last Minute,” AMERICANBANKER.COM, Aug. 9, 2001, at http://www.americanbanker.com [hereinafter An Interview with SunTrust's Humann] (on file with N.C. Banking Institute). After the Wachovia/First Union merger, the new Wachovia “will be No. 1 in deposit share in key SunTrust states such as Virginia and Georgia.” Boraks, SunTrust: No Deal 'Anytime Soon,' supra note 27, at 1. 38. Laura Mandaro & Alissa Leibowitz, Spurned Suitor SunTrust Returns—And This Time It's Hostile, AM. BANKER, May 15, 2001, at 1; see also David Boraks, SunTrust CEO: Won't Raise Wachovia Offer, AM. BANKER, May 31, 2001, at 1. 39. See Armed with Board Support, supra note 26. 40. See First Union Proxy Statement, supra note 13, at 171 (presenting detailed procedure history of various suits filed in connection with the Wachovia/First Union merger by June 26, 2001). 41. Id. 42. Id. at 172. 43. Id. at 171. 44. First Union Corp. v. SunTrust Banks, Inc., 2001 N.C. Bus. Ct., 01-CVS-10975, ¶ 1 (Aug. 10, 2001), available at http://www.ncbusinesscourt.net/opinions/2001%20NCBC%2009A.pdf (last visited Feb. 25, 2002).
of provisions in an option agreement that was part of the merger agreement.\textsuperscript{45}

On July 20, 2001, the North Carolina Business Court invalidated the non-termination provision,\textsuperscript{46} but upheld the validity of the option agreement which provided a termination fee up to $780 million to the non-breaching party in case one merger partner accepted a third party bid.\textsuperscript{47} SunTrust's requests for injunctive relief were denied.\textsuperscript{48} Subsequently, First Union, Wachovia, and SunTrust voluntarily dismissed their claims and counterclaims.\textsuperscript{49} Wachovia shareholders approved the merger with First Union on August 3, 2001.\textsuperscript{50} On September 1, 2001, the new Wachovia Corporation was formed.\textsuperscript{51}

III. CHOICE OF PARTNER: SUNTRUST V. FIRST UNION

As early as the fall of 2000, Wachovia's board adopted a strategy proposed by a consulting firm identifying both First Union and SunTrust as potential merger partners.\textsuperscript{52} During the following months, Wachovia's management had confidential merger negotiations with both First Union and SunTrust separately.\textsuperscript{53} In April 2001, Wachovia's board adopted and recommended to their shareholders a merger with First Union instead of SunTrust.\textsuperscript{54}

\textsuperscript{45} Id.
\textsuperscript{46} Id. \S 166.
\textsuperscript{47} Id. \S 151; see infra notes 122-210 and accompanying text.
\textsuperscript{48} First Union Corp., 2001 N.C. Bus. Ct., 01-CVS-10075, \S 166.
\textsuperscript{50} Boraks, \textit{This Summer's Cliffhanger}, supra note 1, at 4.
\textsuperscript{51} Id.
\textsuperscript{52} First Union Corp., 2001 N.C. Bus. Ct., 01-CVS-10075, \S 93-94 (stating that the strategy was recommended by McKinsey & Co., a consulting firm retained by Wachovia). It is reported that Wachovia might have intended to sell itself because of slipping credit quality and loss of earnings. \textit{See} Liz Moyer, \textit{First Union? SunTrust? What Some Voters Say}, \textit{AM. BANKER}, May 29, 2001, at 1.
\textsuperscript{53} First Union Corp., 2001 N.C. Bus. Ct., 01-CVS-10075, \S 94.
\textsuperscript{54} First Union Proxy Statement, \textit{supra} note 13, at 9-10. First Union's board and Wachovia's board stated the following reasons for their recommendation of the merger: (1) a unique opportunity for substantial earnings accretion in the near term and potential price-earnings multiple expansion in the future; (2) a unique strategic fit of First Union and Wachovia because of their similar geographic scope and product mix; (3) significant cost savings resulting from business unit function reductions, eliminating duplicative staff unit functions, and consolidating facilities;
In a letter to Wachovia shareholders, Baker identified the following reasons for the board’s decision to merge with First Union: (1) shareholders would benefit from “substantial earnings accretion from the outset and potential price-earnings multiple expansion in the future”; (2) Wachovia and First Union had “a genuine sharing of strengths and a cooperative determination of business strategies and practices”; and (3) First Union had recently emerged from a difficult period mainly caused by the integration of two past acquisitions and the result of the transformation was “the revitalization of the company.” Baker also presented several reasons why the board had rejected the SunTrust proposal: (1) a combined SunTrust/Wachovia “would grow more slowly and be less profitable than a combined First Union/Wachovia or . . . Wachovia alone;” (2) there were “insurmountable strategic and operational obstacles to combining SunTrust and Wachovia;” and (3) the potential returns to Wachovia shareholders from an unsolicited acquisition by SunTrust were “unattractive.” Particularly, Baker pointed out that there was no dividend advantage to SunTrust’s unsolicited proposal.

and (4) similar management philosophies and complementary strengths possessed by the respective management teams of First Union and Wachovia. Id.

55. Armed with Board Support, supra note 26. The combination of Wachovia/First Union would be by far larger than that of Wachovia/SunTrust. Mandaro & Leibowitz, supra note 38, at 1. The combined Wachovia/First Union “would have $330 billion of assets and 19 million customers spread up and down the East Coast.” Id. The combined Wachovia/SunTrust “would have $180 billion of assets, 7.5 million retail customers, and leading deposit market shares in Georgia, South Carolina, and Virginia.” Id.


57. Id. But see Moyer, supra note 52, at 1 (pointing to First Union’s recent track record—a string of expensive deals, botched merger integrations, and asset-quality problems—as reason enough to steer clear of a combination).


59. Id. (stating that even with Baker “serving as CEO of a combined SunTrust/Wachovia for two years, maintaining the Wachovia name, and Wachovia directors filling half the board, the divergent strategies for future growth could not be reconciled”).

60. Id. Baker further discussed the board’s concern about SunTrust’s probable lackluster earning growth. SunTrust’s inability to grow important business lines, the deterioration in SunTrust’s core earnings, and serious implementation risk in the SunTrust proposal because SunTrust was very inexperienced in integration activities. Id.

61. Id.
SunTrust CEO Humann believed that SunTrust’s offer was a better combination than the First Union offer. First, SunTrust offered a four percent to seventeen percent premium over First Union’s proposal. Second, only approximately 4,000 employee jobs would be lost, almost none of which would be lost by North Carolina employees, and no North Carolina branches would be closed. In contrast, First Union had announced its merger would result in the loss of 7,000 jobs and the closing of approximately 300 branches. Third, the earnings growth at SunTrust had outpaced First Union’s in each of the past three years.

Both Wachovia’s board and First Union’s board believe that the combined company can achieve cost savings of approximately $890 million per year or eight percent of combined non-interest expenses by the end of 2004. Since First Union and Wachovia have subsidiaries operating in many of the same states, much of their merger is “in-market,” which means that there are likely to be significant cost savings by reducing redundant personnel, closing duplicate branches, and increasing the company’s purchasing power in given markets.

63. Id. Because both SunTrust’s and First Union’s merger proposals are stock-for-stock mergers, the value of their bids constantly changed as the companies’ stock prices rose and fell. Accordingly, the difference between SunTrust’s proposal and First Union’s offer constantly changed as well.
64. Mandaro & Leibowitz, supra note 38, at 1.
66. Id.
67. Id.
68. Chris Serres, SunTrust Holds Firm on Its Offer, NEWS & OBSERVER (Raleigh, NC), July 7, 2001, at D1. SunTrust’s earnings grew by forty-one percent in 2000, rising from $3.04 per share to $4.30 per share. Chris Serres, Now They’ve Gone to Court/SunTrust Sues Wachovia and First Union, Which Fire Back, NEWS & OBSERVER (Raleigh, NC), May 24, 2001, at D1 [hereinafter Now They’ve Gone to Court]. Over the same period, First Union’s earnings declined by ninety-eight percent, falling from $2.95 per share to $.07 per share. Id.
69. First Union Proxy Statement, supra note 13, at 10.
70. Memorandum from Lisa Broome, Law Professor at the University of North Carolina at Chapel Hill and Director of the Center for Banking and Finance at UNC-CH Law School, to author (December 4, 2001) (on file with N.C. Banking Institute) [hereinafter Broome]. See generally First Union Proxy Statement, supra note 13, at 9-10 (stating potential cost savings after the proposed merger); Fed Order Approving
less geographic overlap between SunTrust's and Wachovia's operations.71 As a result, a SunTrust/Wachovia merger would involve fewer employee lay-offs and have less cost-saving potential than a First Union/Wachovia merger.72

Notably, the negotiated merger agreement with First Union provided benefits worth $70 million to key Wachovia executives.73 This caused some Wachovia shareholders to doubt whether the First Union deal was indeed superior as recommended by the management.74 Nevertheless, Raymond C. Groth, an expert in the mergers and acquisitions area, regarded the benefits offered to Wachovia executives as not uncommon compared to those offered in other similar negotiated mergers.75

Following SunTrust's unsolicited merger proposal, First Union, Wachovia, and SunTrust fought an all-out proxy battle. Many of the Wachovia shareholders were believed to be looking at the market prices of SunTrust's proposal and First Union's offer when they voted on the merger with First Union.76 As both offers were stock-for-stock mergers, the constantly changing stock prices of First Union and SunTrust caused change of the value of their offers accordingly.77 Most institutional investors believed that SunTrust's proposal should have been at least seven percent larger than First Union's to convince Wachovia shareholders to take the

the Merger of First Union and Wachovia, supra note 2 (discussing antitrust issues triggered by the merger of First Union and Wachovia).

71. See supra note 2 for a list of states in which Wachovia had subsidiaries. See text accompanying supra note 25 for a list of states in which SunTrust had branches.

72. Broome, supra note 70.

73. First Union Proxy Statement, supra note 13, at 12 (stating that “the value of the incremental payments and benefits the executive officers and directors of Wachovia could receive is $70 million”). Particularly, Mr. Baker would receive $2 million per year for life upon his retirement. Moyer, supra note 52, at 1. Later Mr. Baker relinquished $500,000 of that annual retirement benefit. Id.

74. Moyer, supra note 52, at 1.

75. Telephone interview with Raymond C. Groth, former Senior Vice President and Managing Director of First Union Securities, Inc. (Jan. 9, 2002) (on file with N.C. Banking Institute) [hereinafter Groth Interview]. Since the 1970's, Mr. Groth has worked in a broad range of investment banking activities and is recognized as an expert specialized in the mergers and acquisitions field. Id.

76. Boraks, An Interview with SunTrust's Humann, supra note 37; see also E-mail from Russell M. Robinson II, Founding Partner, Robinson Bradshaw & Hinson, P.A., to author (Oct. 30, 2001, 14:17:35 EST) (on file with N.C. Banking Institute) [hereinafter Robinson, Oct. Email].

77. See supra note 37 and accompanying text.
unusual step of rejecting a negotiated merger agreement at their August 3rd meeting.78 Although SunTrust's proposal would have provided a seventeen percent premium over the First Union merger when SunTrust's unsolicited merger proposal was announced, by the end of the same day the gap shrank to five percent because of the fall of SunTrust's stock price.79

Between the time SunTrust's unsolicited merger proposal was announced and the Wachovia shareholders were asked to vote on the First Union/Wachovia merger agreement, First Union's stock rose about thirteen percent.80 Thus, the difference between SunTrust's offer and First Union's was narrowed to about five percent, which made it difficult for SunTrust to tout a significantly superior proposal in terms of stock price.81 Considering the uncertainty of an unsolicited merger proposal, one New York-based merger and acquisition expert believed the difference between the two proposals was not significant enough to compel shareholders to accept an unsolicited offer.82

Overall, the SunTrust/First Union/Wachovia takeover battle is characterized as unusually hostile in the banking industry because both First Union and SunTrust fought the battle with aggressive attacks in the national media.83 In order to win

79. Id.
81. Wachovia Bought Shares, supra note 80.
82. Chris Serres, Sun Trust Could Up the Ante / Bank Still Has Time to Raise Its Bid, NEWS & OBSERVER (Raleigh, NC), June 28, 2001, at D1 (quoting Tom Burnett, president of Merger Insight, a New York-based firm that provides research on mergers and acquisitions); Boraks, Hostile Bids, supra note 4.
83. See generally Kenneth H. Thomas, Intimations of a World Where Investment Banks Speak Out, AM. BANKER, Sept. 7, 2001, at 7 [hereinafter Thomas, Where Investment Banks Speak Out]. For example, a First Union advertisement titled "Six Things SunTrust Won't Be Talking About Today" appeared in several major newspapers on July 6, 2001, alleging that SunTrust's potential earning growth had
Wachovia shareholder support, First Union and SunTrust ran advertising spots on radio and television stations throughout the Southeast and bought full-page advertisements in major national newspapers, including The New York Times and The Wall Street Journal. The costs were enormous. It was reported that SunTrust spent $30 million in investment banking, advertising, and legal fees in its hostile bid, and First Union and Wachovia spent an estimated three times that to defend their merger.

The costly media war was an unusually prominent feature of the transaction. According to Russell M. Robinson II, a nationally-recognized corporate/banking attorney retained by First Union, the financial analysis published by both sides "served the useful purpose of raising the level of awareness and information for the individual shareholders but probably did not affect the ultimate outcome." The information provided in the advertisements was rudimentary. As always, financial professionals conducted their own analysis of merger proposals, which would filter into the market with or without newspaper advertisements. Thus, the press campaign probably influenced only an insignificant percentage of individual shareholders.

When it came to shareholder votes, institutional investors were the real decision-makers because they owned more than half of the Wachovia stock. Besides the multi-million dollar media campaign, executives at SunTrust made personal appeals to institutional shareholders. Although SunTrust's executives were


84. Serres, Bank War Costly for All Involved, supra note 6, at D1.

85. Id; see also Thomas, Where Investment Banks Speak Out (stating a significant portion of the fees went to investment banks hired by the companies and they provided high-quality financial information and analysis to shareholders). Ironically, the author comments, investment banks should regularly make such information available to shareholders. Id.


87. Id.
88. Id.
89. Id.
90. Robinson, Oct. Email, supra note 76.
91. Serres, Now They've Gone to Court, supra note 68, at D1.
92. Id.
more aggressive in reaching out to the institutional investors than their counterparts at First Union and Wachovia. SunTrust's merger proposal did not have the approval of Wachovia's board. It was uncertain whether a merger with SunTrust would ever be approved by the Wachovia shareholders against the objection of the management. Even if SunTrust successfully merged with Wachovia, a takeover battle of this scale would be extremely costly to the combined new company. Thus, a group of Wachovia shareholders believed that a negotiated merger with First Union was "a bird in the hand," which was better than the unsolicited SunTrust proposal the fate of which was too uncertain. This so-called "bird-in-the-hand" group of shareholders were believed to have cast the decisive votes for First Union.

IV. AMENDMENT OF NORTH CAROLINA CORPORATE LAW

After Wachovia's board rejected SunTrust's bid, SunTrust sought to gain control of Wachovia's board by electing more directors to Wachovia's board who would support SunTrust's proposal. In order to elect additional directors, Wachovia's by-laws would need to be amended to allow shareholders holding ten percent or more of the voting shares to call a special shareholder meeting. On June 4, 2001, SunTrust proposed such an amendment. If Wachovia shareholders approved the by-law amendment, SunTrust intended to call a special shareholder meeting to elect more directors to Wachovia's board who would favor a SunTrust/Wachovia merger. At this point, the North Carolina General Assembly came to the aid of Wachovia and First Union by passing a new law, signed by Governor Mike Easley on

93. Id.
94. First Union Proxy Statement, supra note 13, at 9-10 (Wachovia's board proposing the merger with First Union and rejecting SunTrust's proposal to acquire Wachovia).
95. Robinson, Oct. Email, supra note 76.
96. Boraks, An Interview with Sun Trust's Humann, supra note 37.
97. Serres, New Law Hurts SunTrust, supra note 10, at D1.
98. Id.
100. Id.
June 15, 2001, that amended the state’s corporate law to limit shareholders’ rights in public corporations.101

Under the amended law, special meetings called by shareholders cannot occur unless the procedure is sanctioned by the company’s articles of incorporation.102 The articles of incorporation, however, cannot be amended to include such a procedure without approval from the board of directors.103 The new law made SunTrust’s proposed by-law amendment invalid.104

The new law was viewed by First Union as necessary to allow North Carolina companies “‘to protect themselves against abusive tactics in unsolicited takeover attempts.’”105 Wachovia spokesman Jay Reed said that Wachovia was very pleased that “the state legislature has leveled the playing ground”106 by closing a loophole in state law that would have given SunTrust an unfair advantage in the takeover battle with First Union.107 Mr. Robinson, First Union’s attorney, believes that the legislative amendment was essential to protecting the Wachovia/First Union merger transaction and to avoid losing Wachovia’s headquarters to another state.108 Nevertheless, he suggested that, due to the

102. 2001 N.C. Sess. Laws 2001-201, § 15 (codified as amended at N.C. GEN. STAT. § 55-7-02(a)).
103. Id.; see also First Union Corp., 2001 N.C. Bus. Ct., 01-CVS-10075, ¶ 123 (interpreting the amended statute).
106. Serres, New Law Hurts SunTrust, supra note 10, at D1.
107. Robinson, Oct. Email, supra note 76.
108. Id. Mr. Robinson states,

The amendment of G[eneral] S[tatutes] 55-7-02(a) was needed to defend the First Union/Wachovia deal because of the special circumstances of this case.... Because of the timing of the transaction, the merger was put on the agenda for approval at Wachovia’s postponed annual meeting, instead of at a special meeting of shareholders called just for the purpose of voting on that matter alone. This was unfortunate because it gave SunTrust
disenfranchising effect of the new law, further amendment of the North Carolina General Statutes is needed to allow shareholders of public corporations to have "a reasonable right to call a special meeting."^109

The North Carolina General Assembly arguably had a legitimate motive to join the fight against Atlanta-based SunTrust because the new SunTrust/Wachovia (if SunTrust had won the takeover battle) would have been headquartered in Atlanta, Georgia, which would have been associated with job losses and other adverse economic consequences to North Carolina.^110 However, this argument is problematic. As discussed above, SunTrust's unsolicited merger proposal suggested thousands fewer

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109. ROBINSON, supra note 11, § 8-3, n.1. Mr. Robinson states that amendment is needed to "allow public corporations to have a bylaw giving shareholders a reasonable right to call a special meeting in a manner not subject to unfairness and abuse" intended by SunTrust. Id.

110. See Serres, New Law Hurts SunTrust, supra note 10, at D1.
job cuts than First Union's, and almost none of the combined SunTrust/Wachovia's North Carolina employees would lose their jobs because of the lack of geographical overlap between the two companies. Regardless, many North Carolina attorneys and corporate managers believe that losing Wachovia to an out-of-state company would have been a much greater loss to the State of North Carolina than the closing of some branches as a result of a merger with First Union.

Thomas L. Hazen, a law professor at the University of North Carolina at Chapel Hill, regards it as unfair that North Carolina lawmakers came to the defense of Wachovia and First Union in the middle of a takeover battle. In his opinion, "even if the decision to favor First Union was a good and fair one, it is questionable whether it is proper for the state legislature to do it at all." Professor Hazen further argues, "even assuming that it is proper for the legislature to intervene, then it should do it for this instance only rather than change the entire corporate law." Because the new law deprives the right of shareholders in North Carolina public corporations to call a special meeting without such stipulation in the company's articles of incorporation or the board's consent, the impact of this legislation extends well

111. Knott, Bank's Better Bid., supra note 65, at A16; see also Mandaro & Liebowitz, supra note 38, at 1 (stating that SunTrust expected to eliminate fewer jobs because there would be little geographical overlap between SunTrust's and Wachovia's operations).

112. Robinson, Oct. Email, supra note 76.

113. Hazen Interview, supra note 12.

114. E-mail from Thomas L. Hazen, Cary C. Boshamer Distinguished Professor of Law, University of North Carolina at Chapel Hill, to author (Jan. 22, 2002, 14:07:29 EST) (on file with N.C. Banking Institute) [hereinafter Hazen, Jan. Email].

115. Id. Professor Hazen also states:

... [I]f there was a good reason to favor First Union, then it should have been attempted directly rather than making a statutory amendment that applies to all future situations. The problem the legislature had was not with the statute as it existed but rather with the fact that someone they did not want could use it to their advantage.

Id. However, as Professor Hazen noted, "[T]here could be constitutional problems with a legislature explicitly limiting such a provision to one specific transaction." E-mail from Thomas L. Hazen to author (Feb. 6, 2002, 22:18:09 EST) (on file with N.C. Banking Institute) [hereinafter Hazen, Feb. Email].

beyond the fight for Wachovia. In a June 2001 newspaper article, Professor Tony Plath said, "I can understand why our legislators want to protect First Union, but I'm surprised they would do this at the expense of shareholders." 

In his forthcoming article titled *Silencing the Shareholders' Voice*, Professor Hazen criticizes that the state legislature "blindly acquiesced in the desires of corporate management." He also suggests that the legislature's unilateral rewriting of the governance rights embodied in the corporate charter not only violates the principle of freedom of contract, "it may also be invalid under the Contract Clause of the United States Constitution." According to Professor Hazen, this was not the first time that the North Carolina legislature "has embarked on this unfortunate journey."

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117. Serres, *New Law Hurts SunTrust*, supra note 10, at D1 (referring to the opinion of Tony Plath, a professor of finance at the University of North Carolina at Charlotte).

118. *Id.* (quoting Tony Plath, a professor of Finance at the University of North Carolina at Charlotte). Lee E. Knott, Jr., a long-time Wachovia shareholder who was against the First Union deal, criticized the new law because the North Carolina General Assembly "has permitted itself to be duped into passing a law hostile to shareholders of North Carolina [public] corporations in order to preserve [Bud] Baker's gains." Knott, *Bank's Better Bid*, supra note 65, at A16.


120. *Id.* at 5, 10 & n.30 (explaining that statutory amendments which have the effect of rearranging rights within existing corporations is problematic at best and likely to be unconstitutional). For a general analysis of the constitutional issue involved in corporate mergers, see Nelson Ferebee Taylor, *Evolution of Corporate Combination Law: Policy Issues and Constitutional Questions*, 76 N.C. L. REV. 687 (1998).

121. Hazen, *Silencing the Shareholder's Voice*, supra note 12, at 12 (referring to another example where the North Carolina legislature amended the state's corporate law "without any disengaged consideration of the wisdom of reversing a long-held public policy in order to favor one company" during a takeover bid for Burlington Industries). In 1980s, a Canadian national made a hostile bid for Burlington Industries, a company with substantial presence in North Carolina. See Thomas L. Hazen, *State Anti-Takeover Legislation: The Second and Third Generations*, 23 WAKE FOREST L. REV. 77, 86-87 n. 53 (1988). To help Burlington fend off the takeover bid, a bill was proposed to the North Carolina General Assembly creating takeover barriers for corporations which had more than fifty percent of their assets and employees within the state. *Id.* When the bill was passed, the percentage of the in-state assets required was reduced from fifty percent to forty percent as Burlington was found not to meet the fifty percent threshold. *Id.*
Despite losing the battle to amend Wachovia’s by-laws due to the new law passed by the North Carolina General Assembly, SunTrust did not give up its proposal to merge with Wachovia. SunTrust vigorously pursued its lawsuit in the North Carolina Business Court to enjoin the Wachovia shareholders from voting on the First Union merger agreement. SunTrust claimed the deal protection measures of the Wachovia/First Union merger agreement were coercive and, therefore, invalid.

The Wachovia/First Union merger agreement included two key deal protection measures. The first was a non-termination clause providing that the merger agreement could not be terminated until January 16, 2002, whether or not the Wachovia shareholders approved of the merger. This provision had the effect of preventing Wachovia from entering into any other merger prior to that date. The second was a stock option agreement under which the option holder (First Union) could profit by up to $780 million if the option issuer (Wachovia) accepted a merger offer from a third party before the First Union/Wachovia merger agreement terminated. The option would continue for eighteen months upon termination of the First Union/Wachovia merger agreement if Wachovia abandoned the First Union transaction. SunTrust claimed that the option agreement provided an excessive breakup fee that would effectively block other banks from making bids for Wachovia.

On July 20, 2001, the North Carolina Business Court rejected SunTrust’s motion for preliminary injunction to enjoin consummation of the First Union/Wachovia merger, finding: (1) the non-termination clause in the merger agreement between First

123. Id. ¶ 142.
124. Id. ¶ 118.
125. First Union Proxy Statement, supra note 13, at 15-16.
126. Id. at 16.
128. Id. ¶ 141 (stating that SunTrust characterized the breakup fee as "preclusive").
Union and Wachovia was invalid and therefore, unenforceable;\textsuperscript{129} and (2) the option agreement was non-coercive and hence valid.\textsuperscript{130} Since this was the first time a North Carolina court reviewed a contested merger case,\textsuperscript{131} the court adopted a new approach\textsuperscript{132} to determine the validity of deal protection measures in stock-for-stock mergers.\textsuperscript{133} This new approach is in contrast to the approaches adopted in recent Delaware cases.\textsuperscript{134}

A. North Carolina Approach

Usually, state corporate law provides the most important standards for review of a target corporation’s tender offer defenses.\textsuperscript{135} Some states, including North Carolina, review tender offer defenses by applying the same business judgment rule that would be applicable to an ordinary day-to-day decision made by the board in the absence of self-dealing by any director or manager.\textsuperscript{136}

The most influential state law on corporate boards’ fiduciary duties in a takeover context is the Delaware law which applies a tripartite standard.\textsuperscript{137} In the 1964 Delaware case Cheff v. Mathes, the court established that the board of directors has the burden of proving that it has reasonable grounds to believe that a tender offer presents a danger to corporate policy or effectiveness.\textsuperscript{138} In essence, this burden is a modified business judgment rule imposing a heightened duty of care upon corporate

\textsuperscript{129} Id. ¶ 166.
\textsuperscript{130} Id. ¶ 151.
\textsuperscript{131} Id. ¶ 2.
\textsuperscript{132} Id. ¶ 70.
\textsuperscript{133} Id. ¶ 3 (stating that one issue presented in this case was “what review process will be used by North Carolina courts to determine the validity of deal protection measures in stock-for-stock mergers”).
\textsuperscript{134} See infra notes 135-69 and accompanying text. In this case, North Carolina law controlled.
\textsuperscript{135} JOEL SELIGMAN, CORPORATIONS CASES AND MATERIALS, 1180 (1995).
\textsuperscript{136} Id.; See N.C. GEN. STAT. § 55-8-30(a), (d) (1999).
\textsuperscript{137} SELIGMAN, supra note 135, at 1180.
\textsuperscript{138} See Cheff v. Mathes, 199 A.2d 548, 555 (Del. 1964); see also Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (discussing further the business judgment rule in Delaware).
directors in the change of control context. Under Cheff, directors may "satisfy their burden by showing good faith and reasonable investigation; the directors will not be penalized for an honest mistake of judgment, if the judgment appeared reasonable at the time the decision was made."

The second part of the Delaware standard was established by the Delaware Supreme Court case Unocal v. Mesa Petroleum Co. In Unocal, the court added the balance element to the board's duty when adopting measures to forestall a takeover bid. The court held, "[i]f a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed." Under this approach, if a court finds that the board was reasonable in its perception of a threat and that the defensive measure taken was proportionate to the threat, the court will then judge the board actions by the traditional business judgment rule.

The third part of the Delaware test evolved from the 1985 Delaware case Revlon v. MacAndrews & Forbes. Revlon requires directors to obtain the highest value reasonably available for shareholders in change of control situations. Revlon has been criticized for taking away directors' power to consider the interests of corporate constituents other than shareholders when responding to a hostile takeover attempt. Subsequently, the

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139. SELIGMAN, supra note 135, at 1180; see also Van Gorder, 488 A.2d at 870-98 (judging a good-faith directors' merger decision under ordinary negligence standard).
140. Cheff, 199 A.2d at 555.
142. Id. at 955-96.
143. Id. at 955; see also SELIGMAN, supra note 135, at 1180. The Unocal two-pronged process was subsequently expanded by Unitrin, Inc. v. Am. Gen. Corp. Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361, 12:33-39 (Del. 1995) (establishing that a defensive measure that is outside the normal range of defensive measures or that is "draconian" will not be considered proportionate to the perceived threat, and therefore, fails the Unocal test). The court determined that a draconian measure was one that was preclusive or coercive. Id. at 1387.
144. Unocal Corp., 493 A.2d at 958.
146. Id. at 182.
Delaware Supreme Court has narrowly interpreted the applicability of *Revlon*.  
Recent evaluation of the Delaware approach recognizes that the multiple-standards set forth above are somewhat confusing. In his opinion in *First Union*, Judge Tennille noted, "the straight application of either the business judgment rule or the entire fairness test does not work to resolve the tensions between the conflicting requirements of shareholders and directors in transactions or board actions affecting the shareholders' right to sell or vote." He rejected the *Revlon* standard finding it inconsistent with North Carolina statutes. Section 55-8-30(d) of the North Carolina General Statutes provides, "[t]he 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." The North Carolina Business Court adopted the "circumstance-specific review procedures" developed by Delaware cases, "while avoiding the categorical and linguistic quagmire of the tripartite standard." The court stated that judicial review should promote a structural corporate governance regime with a proper balance between directors' independent

148. See Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987) (asserting that the board's *Revlon* auctioneer duty applies only if the sale of a target company is "inevitable"); see also Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1149-50 (Del. 1989) (rejecting the argument that Time was for sale when Warner shareholders were to receive sixty-two percent of the combined company after a merger).


150. *Id.*

151. *Id.* ¶ 69.

152. N.C. GEN. STAT. § 55-8-30(d) (1999). Section 55-8-30 of the North Carolina General Statute provides:

A director is not liable for any action taken as a director, or any failure to take any action, if he performed the duties . . . [i]n good faith; (2) [w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) [i]n a manner he reasonably believes to be in the best interests of the corporation.

N.C. GEN. STAT. § 55-8-30(a), (d).


154. *Id.*
power to manage and shareholders' right to freely vote on any fundamental changes to the corporation.155

The review process adopted by the North Carolina Business Court in a stock-for-stock merger subject to shareholder approval is as follows:

[T]he court will first review the transaction, including the adoption of deal protection measures, to determine if the directors have complied with their statutory duty of care under N.C.G.S. § 55-8-30. The burden is upon the shareholder challenging their actions to prove that a breach of duty has occurred. If no breach of duty is proven, 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. If a breach of duty is established, the burden shifts to the directors to prove that their actions were reasonable and that it is in the best interests of the shareholders that they be permitted to vote on the transaction, and, if at issue, that the deal protection measures were not actionably coercive and did not prevent the directors from performing their statutory duties. Where the court finds that the deal protection measures are coercive or require directors to breach their statutory duties, the court must then weigh the harm to the shareholders in enjoining either the deal protection measures, the vote on the transaction or the merger, if the transaction is approved, against the harm resulting from not entering injunctive relief. That is a very case- and fact-specific determination.156

155. Id. § 66.
156. Id. § 70.
The key step of this judicial review process is to determine whether the directors have complied with their statutory duty of care under Section 55-8-30(a) of the North Carolina General Statutes which requires a director to act: "(1) [i]n good faith; (2) [w]ith the care an ordinarily prudent person in a like position would exercise under similar circumstances; and (3) in a manner he reasonably believes to be in the best interests of the corporation."\textsuperscript{157} If the challenging shareholders cannot prove the breach of such care by the directors, the court will respect the judgment of the directors.\textsuperscript{158} However, if the shareholders can prove with clear and convincing evidence that the deal protection measures are actionably coercive or require the directors to breach their statutory duties, the burden shifts to the directors to prove otherwise.\textsuperscript{159}

The North Carolina review process differs from the modified business judgment rule established by Delaware law by imposing the burden of proof on challenging shareholders instead of on the directors.\textsuperscript{160} Because shareholders usually do not have access to information necessary to prove a breach of duty on the part of directors, it would be rather difficult for shareholders to prove how the directors breached their duty of care.\textsuperscript{161} Thus, by shifting the burden of proof from the board to shareholders, the North Carolina review process appeared to be more pro-management than the Delaware approach. In Professor Hazen's opinion, "even Delaware which is generally viewed as pro-management does not seem to go as far as North Carolina."\textsuperscript{162}

Arguably, the second step of the North Carolina approach provides one more chance for shareholders to challenge the judgment of directors even though the directors have passed the ordinary care test in the first step.\textsuperscript{163} If the shareholders prove, by clear and convincing evidence, that the deal protection provisions are coercive or would prevent the management from performing

\textsuperscript{157} N.C. GEN. STAT. § 55-8-30(a).
\textsuperscript{158} First Union Corp., 2001 N.C. Bus. Ct., 01-CVS-10075, ¶ 70.
\textsuperscript{159} Id.
\textsuperscript{160} Compare Cheff v. Mathes, 199 A.2d. 548, 555 (Del. 1964).
\textsuperscript{161} Hazen, Jan. Email, supra note 114.
\textsuperscript{162} Id.
\textsuperscript{163} First Union Corp., 2001 N.C. Bus. Ct., 01-CVS-10075, ¶ 70.
their statutory duty of care, the court will intervene and invalidate such coercive or preclusive provisions.164

In effect, the new North Carolina approach is likely to further enhance directors' power to manage and undermine shareholders' rudimentary right to approve merger transactions by imposing the burden of proof upon shareholders who usually lack access to corporate information to upset approval by the directors. This significant set-back to shareholders' rights is unlikely to be offset by the supplementary substantive review of the directors' decisions laid out in the second step when "clear and convincing" evidence calls for court intervention to protect shareholders' voting rights on fundamental corporate changes. If the court consistently applies the ordinary care standard as required by Section 55-7-02(a) of the North Carolina General Statutes, it is hard to see how a board's merger decision could possibly pass the test provided in the first step but fail the test provided in the second step because the standard of the duty of care should remain the same in the second step as in the first step.

Mr. Groth comments that the court's application of the review process in the First Union case does not provide a clear guidance as to what standard of care the court would adopt in any future cases of contested takeover.165 First, the opinion rejected the Delaware approach of an enhanced standard of care in a contested takeover context because the North Carolina statute requires no heightened duty of care from directors in a change of control situation.166 Nevertheless, Mr. Groth states that the court referred to rules created by Delaware cases when it reviewed the decision-making process of Wachovia's board.167 It is not clear how the court would reconcile the potential conflicts between the North Carolina statutory standard of ordinary care with the enhanced standard of care which is an inherent part of Delaware case law in the corporate merger area.168 In Mr. Groth's opinion, this uncertainty inherent in the opinion substantially limits its precedential value.169

164. Id.
165. Groth Interview, supra note 75.
167. Groth Interview, supra note 75; see also First Union Corp., 2001 N.C. Bus. Ct., 01-CVS-10075, ¶¶ 87-92.
168. Groth Interview, supra note 75.
169. Id.
B. Outcome of the First Union Case

Applying the review process discussed above, the North Carolina Business Court found that the Wachovia board had met its statutory duty of care in approving the merger agreement with First Union, including the deal protection measures.\textsuperscript{170} In the first step of its judicial review process, "the court is only seeing that the directors did their job, not questioning their decision."\textsuperscript{171} The court concluded that the Wachovia board complied with its statutory duty of care by making informed, "good faith" decisions.\textsuperscript{172}

The key issue in this case was whether the deal protection measures adopted by the Wachovia board were valid. First, the court recognized the necessity for directors to include reasonable deal protection measures in order to protect the merger partners' contractual rights from interference by other parties.\textsuperscript{173} Judge Tennille stated that some deal protection measures, especially short-term ones, may well be adopted by directors within their statutory duty of care that "have some preclusive effect, without necessarily being coercive of the shareholder vote."\textsuperscript{174} Applying the North Carolina review process, the court heavily relied on the process by which the Wachovia board negotiated, deliberated, and approved the terms of the merger agreement.\textsuperscript{175} Recognizing that the board followed the proper process, the court concluded that the board complied with its statutory duty of care and therefore, the deal protection measures adopted by the board were presumably non-coercive and valid.\textsuperscript{176}

The termination fee that could have been realized by an exercise of the stock option agreements had a floor of $375 million.

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\textsuperscript{170} First Union Corp., 2001 N.C. Bus. Ct., 01-CVS-10075, ¶ 151.
\textsuperscript{171} Id. ¶ 74.
\textsuperscript{172} Id. ¶¶ 131, 141.
\textsuperscript{173} Id. ¶ 76.
\textsuperscript{175} See generally First Union Corp., 2001 N.C. Bus. Ct., 01-CVS-10075, ¶¶ 130-44.
\textsuperscript{176} See generally id.
and a ceiling of $780 million. The option right could be triggered by either of the following two events: (1) "a third party acquire[ing] 25% or more of the common stock of the option issuer;" or (2) "the option issuer agree[ing] to, or recommend[ing] to its shareholders, a business combination or acquisition transaction (other than the proposed merger) with another party that would result in the acquisition of more than 25% of the stock or business of the option issuer or a significant subsidiary." Under this provision, the option right would not be triggered if the Wachovia shareholders simply disapproved the merger with First Union without accepting the merger offer of a third party. In other words, the Wachovia shareholders could not have been coerced to approve the merger with First Union. However, Wachovia would be required to pay a penalty ranging between $375 million to $780 million if it merged or agreed to merge with a third party. As Wachovia and First Union agreed, the cap of $780 million had been reached based on SunTrust's proposal. Seven hundred and eighty million dollars was approximately six percent of the total value of the deal, which was "on the high side" of comparable transactions in the banking industry. Such a high termination fee would preclude other potential merger opportunities.

In this case, the stock options granted to the merger partners function as termination fees to protect the transaction. This type of a deal protection measure is recognized as valid by Delaware courts. Under Delaware law, termination fee provisions are not per se invalid because they could encourage competing bidders and, therefore, further shareholder interests.

177. First Union Proxy Statement, supra note 13, at 15-16.
178. Id. at 15.
179. Id.
180. See First Union Corp., 2001 N.C. Bus. Ct., 01-CVS-10075, ¶ 147 (stating that Wachovia could avoid the termination fee by remaining independent until the option agreement expired).
181. First Union Proxy Statement, supra note 13, at 15-16.
183. Id. ¶ 143.
185. Id. at 1612; see, e.g., In re J.P. Stevens & Co. S'holders Litig., 542 A.2d 770, 782 (Del. Ch. 1988) (involving a case where the target company had two offers from two bidders). The board of the target company induced a higher cash offer from one
Generally, termination fees that have been upheld by Delaware courts are no more than two to three and a half percent of the value of the transaction. However, a termination fee is more likely to be deemed invalid if it is seen as a device primarily motivated by the desire to deter future bidders. In First Union, following SunTrust's unsolicited merger proposal, First Union and Wachovia amended the option agreement to the effect that the profit of the option exercise would reach the $780 million cap.186 At that point, the original merger agreement was already approved by both Wachovia's board and First Union's board. Thus, neither First Union nor Wachovia would have a reason to offer more incentive to the other party in order to induce a merger deal. Among the three amendments made to the option agreement, the modification of the formula for calculating the exercise price of a substitute option was challenged by SunTrust because it allegedly caused the termination fee to be preclusive, and therefore, coercive. Under the old formula, SunTrust would

186. See Varallo & Raju, supra note 184, at 1613 n.9 and accompanying text. For example, the Court of Chancery refused to enjoin a three and a half percent termination fee in McMillan v. Intercargo Corp., C.A. No. 16963 (Del. Ch. Apr. 20, 2000). In another case, a three percent break up fee in a $7 billion transaction was upheld by the Court of Chancery. H.F. Ahmanson & Co. v. Great W. Fin. Corp., C.A. No. 15650 (Del. Ch. June 3, 1997).

187. Varallo & Raju, supra note 184, at 1612 n.8 and accompanying text.


189. Id. ¶ 118. First Union and Wachovia management approved the merger agreement and the original stock option agreements on April 15, 2001. Id. On May 14, 2001, SunTrust publicly announced its unsolicited proposal to acquire Wachovia. Id. ¶ 119. On May 29, 2001, First Union and Wachovia modified the option agreement which was later approved by First Union's board and the executive committee of Wachovia's board. Id. ¶ 124.

190. First Union Corp., 2001 N.C. Bus. Ct., 01-CVS-10075, ¶ 141. The controversy arises out of the word "twice" which was inserted to the calculation formula. Id. ¶ 139. After the amendment, Paragraph Eight of the Stock Option Agreement reads as follows:
have had to pay a $440 million termination fee. However, under the amended formula, the total amount of the termination fee would be doubled. Since this total amount exceeded the $780 million cap, the termination fee was capped at $780 million. In other words, the amendment of the option agreement raised the total amount of termination fee from $440 million to $780 million for SunTrust. Given the suspicious timing of this amendment, it is not unreasonable to inquire whether the option agreement was amended mainly to deter any third-party bid rather than to protect the contracting parties' legitimate interests (e.g., to cover negotiation costs and opportunity cost). However, the court did not look into this question while determining the validity of the stock option clause.

In *First Union*, the court referred to Delaware cases when it reviewed the validity of deal protection measures. Delaware courts review the validity of termination fee clauses under one of two tests: the business judgment rule or the reasonableness of the liquidated damages. When a termination fee exceeds three percent of the value of the transaction, it will likely receive very close judicial scrutiny from a Delaware court because of its potential preclusive effect on shareholder voting or a third party bid.

In *First Union*, the termination fee, as a result of the exercise of the option agreement, would certainly reach the $780 million cap, which is approximately six percent of the value of the

The Substitute Option shall be exercisable for such number of shares of Substitute Common Stock as is equal to the Assigned Value multiplied by "twice" the number of shares of Common Stock for which the Option was exercisable immediately prior to the event described in the first sentence of Section 8(a).

*Id.* ¶ 140.
191. *Id.*
192. *Id.*
193. *Id.*
195. *Id.*
196. *Id.* ¶¶ 78-86.
197. Varallo & Raju, *supra* note 184, at nn.9-18 and accompanying text.
198. *Id.* at n.18 and accompanying text (discussing stock option provisions that function as breakup fees).
Absent any other justifications for this unusually high termination fee, the court primarily relied on the marketplace test in order to determine whether this termination fee amount was impermissibly preclusive. The court held that the termination fee was allowable for several reasons. First, Wachovia stock was persistently traded at a higher price than the value of the First Union/Wachovia merger agreement after the announcement of the proposed merger. Apparently, "the market . . . did not believe other offers were precluded." Second, SunTrust stated in its proxy statement that it was prepared to pay the full $780 million breakup fee and still offer Wachovia shareholders a superior deal. Third, Wachovia shareholders would not suffer a huge loss if they disapproved the merger because they could wait until the eighteen-month option expired to entertain another offer.

Arguably, the court gave too much weight to the marketplace test. First, Wachovia stock might be overpriced because of imperfect information accessible to traders. For instance, SunTrust's unsolicited merger proposal might be a key reason for the arguable "over-pricing" of Wachovia stocks. Second, despite SunTrust's statement, it eventually failed to offer a substantively superior offer to Wachovia shareholders. Apparently, the court did not doubt SunTrust's intent to carry out its promise. Otherwise, the court would not have based its opinion, at least in part, on SunTrust's statement. It could be argued that the very fact that SunTrust failed to present a meaningfully superior offer proves the preclusive effect of the huge breakup fee. Finally, the court seemed to contradict its own view presented in the later part of the opinion by asserting that the option agreement was not coercive because Wachovia shareholders could simply wait out the eighteen-month duration of the option agreement. In Part B of Section V of the opinion, the court pronounced the non-termination clause coercive and thus

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200. See id. ¶¶ 145-57; see also infra notes 201-04 and accompanying text.
202. Id.
203. Id. ¶ 146.
204. Id. ¶ 147.
205. Id. ¶ 146.
invalid because it would preclude the Wachovia board from considering or recommending other merger deals for five months after a shareholder vote disapproving the merger with First Union. If, as the court held, it was not coercive for Wachovia shareholders to wait for eighteen months without considering any business combination with a third-party, why was it coercive for them to wait for only five months? The court did not reconcile its conflicting rulings regarding those issues.

The marketplace test should not be the sole test relied upon by a court to evaluate the preclusive effect of a key break-up fee clause. In addition to the marketplace test, the court should also determine whether the main motivation of the break-up fee provision is to deter third party bids or to cover reasonable transaction costs (including opportunity costs and costs for regulatory approval).

VI. CONCLUSION

On September 1, 2001, the new Wachovia emerged from the completed merger of First Union and Wachovia. The combined company has received optimistic reviews from Wall Street as to its long-term prospects. Besides the new Wachovia, headquartered in Charlotte, the merger of First Union and Wachovia left two significant legacies to the State of North Carolina. First, the North Carolina corporate statutes were amended to prevent shareholders of public corporations from calling a special shareholder meeting without the consent of the board or a proper provision in the company's articles of incorporation. This new law significantly undermines the shareholders' right to vote on fundamental corporate changes including merger deals.

207. Id. ¶¶ 155-63.
208. Id. ¶ 147.
209. Id. ¶¶ 161-62.
210. See supra notes 184-95 and accompanying text.
211. See Boraks, This Summer's Cliffhanger, supra note 1, at 4.
212. See id.
213. See supra notes 214-220 and accompanying text.
215. See supra notes 97-109 and accompanying text.
The second legacy was a judicial review process for deal protective measures in contested takeovers.216 In First Union Corp., the North Carolina Business Court undertook to develop judicial tools to strike the appropriate balance between shareholder power and board authority in corporate mergers.217 This was the first time a North Carolina court had the opportunity to review a contested takeover of a public corporation.218 The approach which the court adopted was pro-management because it placed the burden upon the shareholders to prove that the board breached its fiduciary duty in a contested takeover context.219 The North Carolina Business Court's opinion in First Union is an important precedent for contested takeover cases in the banking industry where hostile bids are still rare but are expected to grow more common in the future.220

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216. See supra notes 153-59 and accompanying text.
217. See supra notes 153-59 and accompanying text.
218. See supra notes 131-33 and accompanying text.
219. See supra notes 160-64 and accompanying text.
220. See David Boraks, Hostile Bids, supra note 4, at 1 (citing changes to accounting rules and a shrinking pool of attractive franchises as reasons to spur a rise in hostile takeover bids in financial market).