

IN THE SUPREME COURT OF THE STATE OF DELAWARE

UNOCAL CORPORATION,
a Delaware corporation,

Defendant Below-
Appellant

v.

No. 152, 1985

MESA PETROLEUM CO., a
Delaware corporation, MESA
ASSET CO., a Delaware
corporation, MESA EASTERN,
INC., a Delaware corporation,
and MESA PARTNERS II, a Texas
partnership,

Plaintiffs Below-
Appellees

) Appeal from Judgment
) in the Court of
) Chancery in and for
) New Castle County in
) C.A. No. 7997

Superior Court Courtroom No. 1
Public Building
Wilmington, Delaware

Friday, May 17, 1985
9:00 a.m.

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RULING OF THE COURT

VARALLO & WILCOX
913 Market Street Mall, Wilmington, Delaware 19801
(302) 655-0477



BEFORE: Hon. John J. McNeilly,
 Associate Justice

 Hon. Andrew G. T. Moore II,
 Associate Justice

 Hon. Clarence W. Taylor,
 Judge of the Superior Court

APPEARANCES:

A. Gilchrist Sparks, III, Esq.
 Kenneth J. Nachbar, Esq.
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 - and -

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 For Defendant Below-Appellant

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 Wilmington, Delaware 19801
 for Plaintiffs Below-Appellees

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P R O C E E D I N G S

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JUSTICE McNEILLY: Good morning, ladies and gentlemen.

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The court is prepared this morning to read into the record the decision of the court in the Unocal case and I'll ask Justice Moore to please read the decision of the court, which will be followed by a more lengthy opinion.

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In addition, we'll ask that no one leave the courtroom until the court is recessed. An order will be prepared and it may be picked up at the State Building in the Supreme Court chambers in about half an hour, at 9:30.

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Justice Moore will now read the decision of the court.

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JUSTICE MOORE: In announcing our decision today, we will attempt to state certain of the principles upon which our action is taken. Necessarily, given the expedition by which this matter has been handled and the need to render a prompt decision today, this will not be a complete exposition of our views. A more detailed written opinion will follow in due course.

1 We accepted this interlocutory appeal
2 following the issuance of a preliminary injunction
3 by the Court of Chancery against the defendant
4 Unocal Corporation and certain of its officers and
5 directors prohibiting them from proceeding with an
6 exchange offer commenced by Unocal as a defensive
7 response to Mesa's efforts to acquire Unocal. The
8 matter has been heard by us on an expedited basis.
9 We accepted this appeal on Tuesday, May 14, 1985,
10 received excellent briefs from counsel, heard oral
11 argument on Thursday, May 16, 1985, and are
12 rendering this decision at 9:00 a.m. on Friday,
13 May 17, 1985.

14 Such expedition is required by the fact
15 that if Unocal's exchange offer is permitted to
16 proceed, the proration date for the shares entitled
17 to be exchanged is today, while Mesa's tender offer
18 expires on Thursday, May 23.

19 On April 8, 1985, Mesa commenced a
20 tender offer for 64 million shares or 51 percent of
21 the common stock of Unocal at \$54 cash net per share
22 and announced its intention to propose the
23 acquisition of the remaining publicly held shares of
24 Unocal in exchange for securities having an

1 aggregate market value of \$54 per share. This is
2 known as a two-tier front-end loaded tender offer
3 followed by a back-end merger in which the remaining
4 public shareholders of Unocal would be squeezed out
5 by the issuance of highly subordinated securities,
6 resulting in a capitalization of the surviving
7 company which would differ significantly from that
8 of Unocal as it is today. Mesa's May 3, 1985,
9 supplement to its proxy statement acknowledges this
10 fact.

11 Unocal contends that this offer,
12 although substantially above market, is grossly
13 inadequate in terms of paying Unocal's shareholders
14 the intrinsic value of their stock. Valuations made
15 by responsible investment bankers retained by Unocal
16 indicate that its stock has a minimum cash value in
17 excess of \$60 per share and in an orderly
18 liquidation, the stock may be worth \$70 to \$75 per
19 share. Mesa's own valuations, including those by
20 its investment bankers, acknowledge that the net
21 asset value of Unocal may be as high as \$79 per
22 share. Mr. Pickens of Mesa has publicly
23 acknowledged that Unocal's value is somewhat less
24 than \$80 per share.

1 Following extended meetings with
2 investment bankers and others, the Unocal board
3 adopted the exchange offer here under attack. Its
4 provisions are based upon recommendations made to
5 the Unocal board by investment bankers. As
6 presently constituted, the exchange offer provides
7 for a self-tender of 87,200,000 shares of Unocal's
8 stock in exchange for senior debt securities having
9 a value of \$72 per share. Mesa's principal,
10 Mr. Pickens, has testified that the \$72 exchange
11 offer is reasonable. However, by its terms, neither
12 Mesa nor any of its affiliates are entitled to
13 participate in the offer. This is known as the Mesa
14 exclusion.

15 Originally the exchange offer was
16 subject to the condition that Mesa first acquire
17 64 million shares of Unocal's stock. Later that
18 condition was waived as to 50 million shares. While
19 Mesa does not challenge the monetary fairness or
20 reasonableness of the exchange offer itself, it
21 contends that its exclusion from any participation
22 in the exchange offer is discriminatory in the sense
23 that it alone has been denied the right to
24 participate in a corporate benefit open to all other

1 Unocal shareholders. Thus, Mesa contends and the
2 Court of Chancery agreed that the exchange offer as
3 constituted does not meet the test of fairness by
4 which this transaction should be judged.

5 On the other hand, Unocal contends that
6 the exchange offer is a measured response taken by
7 its board of directors in the proper exercise of
8 business judgment to protect Unocal's shareholders
9 from a grossly inadequate, coercive, two-tier front-
10 end loaded tender offer. In its decision of May 13,
11 1985, the Court of Chancery found that the Unocal
12 board's action respecting the exchange offer was
13 made, quote, "in the good-faith belief that the Mesa
14 tender offer is inadequate"; that the board's action
15 was informed and taken with due care; that the facts
16 of record justify a reasonable inference that Mesa's
17 principal objective is to, quote, "be bought off at
18 a substantial premium," end quote.

19 However, the Vice Chancellor ruled that
20 Unocal's duty to treat Mesa fairly even in the face
21 of its takeover efforts prohibited Mesa's exclusion
22 from the exchange offer. The trial court and the
23 parties seem to be in agreement that the directors'
24 duty of care to the corporation extends to

1 protecting the corporate enterprise in good faith
2 from perceived depredations of others including
3 company stockholders. However, it distinguishes
4 certain Delaware cases which heretofore have
5 accepted the principle that a corporation may deal
6 selectively with its shareholders in repurchasing
7 their stock in order to protect the corporate
8 enterprise from a dissident.

9 We approach these issues in a different
10 way. The Unocal board consists of fourteen
11 directors, eight of whom are outsiders. All of the
12 outside directors who participated in the decision
13 unanimously recommended the exchange offer before
14 its formal adoption by the whole board. Thus, we
15 start with the principle announced in *Pogostin v.*
16 *Rice*, 480 Atlantic 2d at 627, that the availability,
17 function, and operation of the business judgment
18 rule including the standards by which director
19 conduct is judged, is applicable in the context of a
20 takeover. Provided the decision is an informed one
21 and absent a primary purpose of self-perpetuation in
22 office, fraud, overreaching or lack of good faith,
23 the directors' actions in meeting a takeover threat
24 are valid exercises of business judgment and

1 entitled to the respect accorded them by the
2 business judgment rule.

3 Mesa contends that the business
4 judgment rule is inapplicable because the directors,
5 by tendering their shares, are receiving a benefit
6 which does not generally devolve upon all
7 shareholders equally since Mesa will not receive the
8 benefits of tendering its shares. Unocal, however,
9 contends and Mesa conceded at oral argument that if
10 the Mesa exclusion is valid, then the directors are
11 not benefiting from the transaction in any way
12 different from the other shareholders who may
13 participate in the exchange offer.

14 While we believe that the business
15 judgment rule generally is applicable to defensive
16 measures including the exclusion of a raider from
17 participation in this type of self-tender, the
18 responses of the board to the perceived threat must
19 be judged at the outset by the nature of the threat
20 itself. Here the objective of the exchange offer is
21 to protect Unocal shareholders from a grossly
22 inadequate and coercive two-tier front-end loaded
23 tender offer. The shareholders are thus faced with
24 the prospect of accepting \$54 in cash or later

1 receiving \$54 in what the board has concluded are
2 junk bonds.

3 A hallmark of the business judgment
4 rule is that a court will not substitute its
5 judgment for that of the board if the latter's
6 decision can be, quote, "attributed to any rational
7 business purpose," unquote. See Sinclair oil
8 Corporation v. Levien, 280 Atlantic 2d at 720.

9 Considering that the Vice Chancellor
10 found that the exchange offer was based on the
11 board's good-faith belief that the Mesa offer was
12 inadequate, that the board's action was informed and
13 taken with due care and that Mesa's prior activities
14 justify a reasonable inference that its principal
15 objective is greenmail, we cannot conclude that the
16 Unocal directors have acted in such a manner as to
17 have cast an unintelligent and unadvised judgment.
18 See Mitchell v. Highland Western Glass Co.,
19 167 Atlantic at 833.

20 While we caution boards of directors of
21 Delaware corporations that they do not have
22 unbridled discretion to defeat any perceived threat
23 to corporate control by any Draconian means
24 available, we are satisfied that in the context of

1 this inadequate tender offer Unocal's action is not
2 so irresponsible and unjustified as to remove it
3 from the ambit of the business judgment rule.

4 Under the circumstances we have no
5 recourse but to reverse the decision of the Court of
6 Chancery and to order the preliminary injunction
7 vacated.

8 JUSTICE McNEILLY: That being the
9 decision of the court, we will recess to the call of
10 the court.

11 (Hearing concluded at 9:14 a.m.)
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C E R T I F I C A T E

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I, J. Edward Varallo, Registered
Professional Reporter and Notary Public for the
State of Delaware, do hereby certify that the
foregoing record, pages 1 to 11 inclusive, is a true
and accurate transcript of my stenographic notes
taken on Friday, May 17, 1985, in the above-
captioned matter before the Supreme Court of the
State of Delaware.

IN WITNESS WHEREOF, I have hereunto set
my hand and seal this _____ day of May, 1985, at
Wilmington.
