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Directors & Officers

Fiduciary Duties

Fiduciary Duties in Hostile Takeover Scenarios


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On the evening of January 24, 2012, the pharmaceutical giant Roche Holding AG publicly announced its intent to acquire all the outstanding shares of Illumina, Inc., a gene sequencing company, in a deal that would be worth approximately $5.7 billion and represented an 18 percent premium over Illumina's then-current stock price. In response, and "in order to protect stockholders from coercive or otherwise unfair takeover tactics," Illumina's board of directors immediately adopted a shareholder rights agreement, better known as a "poison pill," and announced it would review the offer in consultation with its financial and legal advisors, "consistent with its fiduciary duties."[1] That did not, however, prevent at least one national class action and shareholder rights law firm from announcing that it was investigating Illumina's board for possible breaches of fiduciary duty and other violations of law in connection with Roche's unsolicited offer to purchase Illumina.[2]

With the economic recovery slowly taking hold, observers note that there are good reasons to believe M&A activity will grow in 2012—many companies have significant cash resources and banks are increasingly willing to lend cash for acquisitions. Hostile takeovers, such as the one currently being conducted by Roche, will almost certainly make up a significant minority of those transactions, which means it might be a good time for directors of potential targets to review their fiduciary duties under Delaware law in those circumstances, as well as their company's takeover defenses.

Under normal circumstances, the basic standard of review of judicial inquiry into board decisions is the business judgment rule, which also may apply to certain merger scenarios. Under the business judgment rule, courts will defer to the decisions of the board, which are presumed to have been made in good faith, on an informed basis and in the honest belief that the action was taken with the best interests of the company in mind.[3] Judicial review of board action will be enhanced in certain situations, however, and board action in defense against an unsolicited and unwelcome takeover offer is one such situation. Where the board has adopted a defensive mechanism in response to a perceived threat to control or policy, the Delaware courts will employ an enhanced scrutiny standard which evaluates both board action and process.

The enhanced scrutiny standard, first articulated by the Delaware Supreme Court in *Unocal Corp. v. Mesa Petroleum Co.*, provides for a two-step analysis of board defensive action.[4] In the first instance, the incumbent board has the burden of proving that it acted in good faith after reasonable investigation, the burden being so placed because the target directors are operating under the suspicion that that they may be acting primarily for their own benefit, rather than in the interests of the corporation as a whole and its shareholders. This is, essentially, the business judgment rule without the presumption of good faith. Convinced that the board acted in good faith after reasonable inquiry, the court will then examine the defensive mechanism employed and determine whether or not it was reasonable in relation to the threat posed to corporate control or policy, which may be determined by looking to the objective reasonableness of the particular defensive tactics chosen in light of the circumstances. Satisfied that the board acted in good faith and employed a reasonable defensive mechanism, the court will provide the board's decision with the protections afforded by the business judgment rule.

As recently as last year, the Delaware Chancery Court in *Air Products & Chemicals, Inc. v. Airgas, Inc.*, opined that a board of directors that had acted in good faith and had a reasonable basis for believing that a structurally non-coercive, all-cash tender offer was inadequately priced could maintain a poison pill as a valid defense against the takeover.[5]

Directors can take the current Roche-Illumina takeover drama as a reminder to ensure they are well prepared to engage with a potential hostile acquirer while fulfilling their fiduciary duties. This may mean reviewing their current corporate takeover defenses or re-examining their decision to adopt (or not adopt) a shareholder rights plans and other takeover repellents.

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[1] Illumina, Inc., Current Report (Form 8-K) (January 27, 2012); Current Report (Form 8-K) (January 26, 2012).

[2] http://www.businesswire.com/news/home/20120125006669/en/MURRAY-FRANK-LLP-Announces-Investigation-Illumina

[3] *E.g., Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000).

[4] 493 A.2d 946 (Del. 1985).

[5] 16 A.3d 48 (Del. Ch. Feb. 15, 2011).