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NIGHTMARE ON MAIN STREET: THE *PARAMOUNT* PICTURE HORROR SHOW©

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I. INTRODUCTION

Nearly a decade ago, in an article published in this journal,[1] I commented that the state of Delaware had ended its role in the "race for the bottom."[2] Shareholders are protected today in Delaware, I asserted,[3] pointing to such cases as *Singer v. Magnavox Co.*[4] and *Zapata Corp. v. Maldonado*.[5] Unfortunately, the last decade, culminating with the Delaware Supreme Court's decision in *Paramount Communications, Inc. v. Time Inc.*,[6] evidences that I am at times a "wishful thinker."

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1. Ferrara & Steinberg, *The Interplay Between State Corporation and Federal Securities Law*—Santa Fe, Singer, Burks, Maldonado, *Their Progeny & Beyond*, 7 DEL. J. CORP. L. 1 (1982).

2. *Id.* at 3 ("Delaware, above all states, has come a long way toward protecting the rights of shareholders and promoting the fundamental concept of corporate accountability."). *See generally* M. STEINBERG, CORPORATE INTERNAL AFFAIRS 177-81 (1983) (discussing the protection afforded minority shareholders in a cash-out merger); Ferrara & Steinberg, *A Reappraisal of* Santa Fe: *Rule 10b-5 and the New Federalism*, 129 U. PA. L. REV. 263 (1980) (discussing the position of federal and state courts regarding minority shareholders).

3. *See* Ferrara & Steinberg, *supra* note 1, at 7-9, 21-29.

4. 380 A.2d 969 (Del. 1977).

5. 430 A.2d 779 (Del. 1977).

6. 571 A.2d 1140 (Del. 1990).

In Delaware today, shareholder protection is all too often largely rhetorical, lacking in substantive content.

This article examines Delaware's plight in shareholder disregard. First, the article presents an overview of key Delaware Supreme Court decisions in the shareholder rights area handed down in the 1970s and 1980s. Although the initial impression of these cases may convey that the law of fiduciary duty is vigilant in Delaware, closer analysis reveals that laxity all too often prevails.[7] The article then turns to the Delaware high court's decision in *Paramount*, presenting a critical analysis of the court's rationale. Last, the article posits that, although Delaware slights legitimate shareholder interests, it is more protective of those interests than a number of other states. To do more for shareholders could induce management to seek incorporation elsewhere,[8] spelling doom for Delaware's economic welfare (or, at the very least, the levying of significantly higher taxes upon Delaware's residents).[9]

II. OVERVIEW OF DELAWARE DECISIONS—RHETORIC V. CONTENT

This section briefly focuses on three subjects in the shareholder rights area addressed by the state of Delaware in the fairly recent past: cash-out mergers,[10] shareholder derivative litigation,[11] and the fiduciary duty of care.[12] The purpose of the ensuing discussion is to stress that the *Paramount* decision should not be viewed in isolation but rather as representative of Delaware's focus on rhetoric that offers little substantive value to shareholders.

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7. *See generally* Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663 (1974) (arguing for federal involvement in state corporate law with emphasis on Delaware as the leader in the deterioration of corporate standards); Latty, *Why Are Business Corporation Laws Largely "Enabling"?*, 50 CORNELL L.Q. 599 (1965) (discussing why corporate law is "enabling" and not protective of shareholders); Comment, *Law for Sale: A Study of the Delaware Corporation Law of 1967*, 117 U. PA. L. REV. 861 (1969) (analyzing the drafting and enactment of the Delaware Corporation Law of 1967).

8. *See* Hanks, *State Legislative Responses to the Director Liability Crisis*, 20 REV. SEC. & COMM. REG. 23, 25 (1987). *See also supra* note 7.

9. *See* Romano, *Law as a Product: Some Pieces of the Incorporation Puzzle*, 1 J. ECON. & ORGANIZATIONS 225, 240 (1985) (revenues derived from corporate chartering constitute almost 17% of Delaware's tax revenues).

10. *See infra* notes 13-38 and accompanying text.

11. *See infra* notes 39-64 and accompanying text.

12. *See infra* notes 64-76 and accompanying text.

A. *Cash-Out Mergers*

With respect to cash-out mergers, the Delaware Supreme Court held in *Singer v. Magnavox Co.*[13] that appraisal is not a minority shareholder's sole remedy when challenging a merger's unfairness.[14] In such circumstances, to comply with its fiduciary duty, the majority must show a proper business purpose and that the minority was treated with "entire fairness."[15] Subsequently, in *Lynch v. Vickers Energy Corp.*,[16] the minority was afforded a meaningful damages remedy for the majority's breach, the "rescissory" measure of damages.[17]

Yet, in *Tanzer v. International General Industries*,[18] the Delaware high court emasculated *Singer*'s business purpose test.[19] Rather than confining such business purpose to solely that of the subsidiary corporation, the court held that the standard is satisfied if the transaction effectuates a bona fide purpose of the majority.[20] *Tanzer*'s effect was to eviscerate the content of the business purpose test.

In *Weinberger v. UOP, Inc.*,[21] the Delaware Supreme Court ruled that *Singer*'s business purpose test no longer retained vitality.[22] Instead, the sole standard to be applied is "entire fairness," looking to fair dealing and fair price.[23] The court's construction of fair dealing, however, signified that minority shareholders would be able to state a claim for breach of fiduciary duty (and avoid appraisal) in fewer situations than under *Singer*, namely, only when "fraud, misrepre-

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13. 380 A.2d 969 (Del. 1977).

14. *Id.* at 980.

15. *Id.* (relying on Sterling v. Mayflower Hotel Corp., 33 Del. Ch. 293, 298, 93 A.2d 107, 110 (1952)). *See* Brudney & Chirelstein, *A Restatement of Corporate Freezeouts*, 87 YALE L.J. 1354 (1978).

16. 429 A.2d 497 (Del. 1981) (*Lynch II*).

17. *Id.* at 501. Generally, "rescissory damages" are the monetary equivalent of rescission where actual rescission of the merger is impractical. In effect, a rescissory measure of damages awards the equivalent of the stock at the time of resale, if applicable, or at the time of judgment, thereby allowing the minority shareholder to receive the appreciation in value that the majority shareholder otherwise would enjoy as a result of purchasing and holding the shares. *Id.* (citing 12 A. FLETCHER CYCLOPEDIA CORPORATIONS § 5598 (perm. ed. 1984)).

18. 379 A.2d 1121 (Del. 1977).

19. *See* Weiss, *The Law of Take-Out Mergers: A Historical Perspective*, 56 N.Y.U. L. REV. 624, 664 (1981).

20. *Tanzer*, 379 A.2d at 1124-25.

21. 457 A.2d 701 (Del. 1983).

22. *Id.* at 715.

23. *Id.*

sentation, self-dealing, deliberate waste of corporate assets, or gross and palpable overreaching" were shown.[24] And, if such breach were established, the award of "rescissory" damages, rather than being an entitlement for aggrieved minority shareholders, would be within the chancery court's discretion to grant.[25]

In regard to fair price, the *Weinberger* court expanded acceptable valuation techniques to encompass the consideration of reputable forward-looking information.[26] To gain the benefit of this valuation formula, however, a minority shareholder either must establish breach of fiduciary duty by showing one of the five exceptions enumerated in *Weinberger*[27] or seek appraisal.[28] Importantly, to come within the time-consuming appraisal remedy,[29] a shareholder must perfect that right.[30] Failure to do so will relegate the shareholder to accepting the consideration offered by the corporation (unless breach of fiduciary duty is proven).[31]

Even for those shareholders desiring to invoke this less than admirable remedy,[32] perfecting the appraisal remedy has been made

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24. *Id.* at 714.

25. *Id. See also id.* at 703-04 (overruling *Lynch II* "to the extent that it purports to limit a stockholder's monetary relief to a specific damage formula"). *See* Steinberg & Lindahl, *The New Law of Squeeze-Out Mergers*, 62 WASH. U.L.Q. 351, 364-66, 390-92 (1984).

26. *Weinberger*, 457 A.2d at 713. The decision suggests that acceptable valuation techniques may include future earnings discounted to present value and premiums offered in comparable situations.

27. *Id.* at 714. *See supra* notes 24-25 and accompanying text. *See also* Rabkin v. Philip A. Hunt Chem. Corp., 498 A.2d 1099 (Del. 1985).

28. *See* DEL. CODE ANN. tit. 8, § 262(h) (1983), *construed at Weinberger*, 457 A.2d at 712-13.

29. The practical utility of the appraisal remedy has been heavily criticized. *See* Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 304-07 (1974); Coleman, *The Appraisal Remedy in Corporate Freeze-Outs: Questions of Valuation and Exclusivity*, 38 SW. L.J. 775 (1984); Seligman, *Reappraising the Appraisal Remedy*, 52 GEO. WASH. L. REV. 829 (1984). *See generally* AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS 224 (Tent. Draft No. 10, 1990) ("Delaware courts have also acknowledged, but not yet adequately responded to, the criticism that 'the procedural prerequisites for an appraisal remain technical and burdensome.'").

30. *See* DEL. CODE ANN. tit. 8, § 262 (1983 & Cum. Supp. 1988). As asserted by one commentator: "The [appraisal] procedure has grown long and expensive and . . . courts have tended to be increasingly stringent in enforcing the procedural letter" of the statutes. Manning, *The Shareholders' Appraisal Remedy: An Essay for Frank Coker*, 72 YALE L.J. 223, 231 (1962). Moreover, "the only thing[s] certain [in the appraisal process] are the uncertainty, the delay, and the expense." *Id.* at 233. *See* sources cited *supra* note 29.

31. *See Weinberger*, 457 A.2d at 714-15.

32. *See supra* notes 29-30.

more cumbersome by the Delaware Supreme Court's position that only shareholders of record may perfect that right.[33] Given that stock today is often held in "street name,"[34] the likely result will be that fewer beneficial owners, due to the time constraints involved, will be able to seek appraisal.[35]

That is not to suggest that the *Weinberger* approach is only protective of management. Unlike the uncertainty of *Singer* and its progeny,[36] the standard adopted in *Weinberger* facilitates the effectuation of mergers and commercial certainty. As such, the decision may promote economic growth.[37] But what it does not do is advance minority shareholder welfare.[38]

B. Shareholder Derivative Litigation

Shareholder derivative litigation, particularly the requirement of demand on the board of directors,[39] provides a second example of the Delaware Supreme Court's retreat in protecting shareholders. In *Zapata Corp. v. Maldonado*,[40] the court held that, in situations where demand on the board of directors is required, the business judgment rule would apply to a decision by the disinterested members of the board to dismiss the suit.[41] Where, on the other hand, demand is

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33. *See* Enstar Corp. v. Senouf, 535 A.2d 1351, 1354 (Del. 1987) (asserting that "[t]he legal and practical effects of having one's stock registered in street name cannot be visited upon the issuer").

34. *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 29, at 273.

35. *Id.* ("Cases recurrently arise in which the beneficial owner is denied a remedy because either the broker or the depositary has delayed too long in notifying the corporation, with the result that the vote is taken before this two-step process of demanding appraisal through the legal record owner is completed.") (citing as examples Enstar Corp. v. Senouf, 535 A.2d 1351 (Del. 1987); Tabbi v. Pollution Control Indus., Inc., 508 A.2d 867 (Del. Ch. 1986)). *But see* Cede & Co. v. Technicolor, Inc., 542 A.2d 1182 (Del. 1988) (may be viewed as a decision favoring minority shareholders as the court permitted an appraisal proceeding and a subsequent breach of fiduciary duty action to go forward).

36. *See* Ferrara & Steinberg, *supra* note 1, at 8-9.

37. *See* M. STEINBERG, SECURITIES REGULATION: LIABILITIES AND REMEDIES § 15.09 (1990) ("The decision is essentially an economic one designed to facilitate mergers.").

38. *Id. But cf.* Cede & Co. v. Technicolor, Inc., 542 A.2d 1182 (Del. 1988) (permitting minority shareholder to proceed with an appraisal proceeding and breach of fiduciary claim).

39. *See infra* notes 52-63 and accompanying text.

40. 430 A.2d 779 (Del. 1981).

41. *Id.* at 784 n.10 ("[W]hen stockholders, after making demand and having their suit rejected, attack the board's decision as improper, the board's decision falls under the 'business judgment' rule and will be respected if the requirements of the rule are met."). *Accord* Spiegel v. Buntrock, 571 A.2d 767 (Del. 1990).

excused, a two-factor test applies in determining whether a court should validate a special litigation committee's recommendation that the action be dismissed.[42] First, with the movant bearing the burden of proof, the court should assess the committee's independence, good faith, and basis for its conclusions.[43] Second, provided that the first step is satisfied, the court may apply its own independent business judgment and, when appropriate, also consider matters of public policy.[44] The court called this second step an "essential key."[45]

Zapata was applauded as a reasonable balance between a shareholder's right to institute derivative suits in order to seek redress based on misconduct by corporate fiduciaries and the corporation's legitimate need to rid itself of vexatious shareholder litigation.[46] It did not take long, however, for the court to deprive *Zapata* of its strength. Two examples will suffice. First, the court in *Kaplan v. Wyatt*[47] held that *Zapata*'s second step is discretionary.[48] In so holding, the court declined to discuss or cite its language in a case decided one year earlier that a court "must" proceed to the second step.[49] *Zapata*'s second step, constituting in the court's own words, "the essential key,"[50] is now often superfluous as the chancery court may dismiss a shareholder's claim without ever reaching this step.[51]

The second crucial issue left open by *Zapata* was when demand on the board of directors would be required.[52] In *Zapata*, demand

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42. *Zapata*, 430 A.2d at 788.

43. *Id.*

44. *Id.* at 789.

45. *Id.* (describing the second step as "the essential key in striking the balance between legitimate corporate claims as expressed in a derivative stockholder suit and a corporation's best interests as expressed by an independent investigating committee").

46. *See* Ferrara & Steinberg, *supra* note 1, at 25-29. *See generally* Coffee & Schwartz, *The Survival of the Derivative Suit: An Evaluation and a Proposal for Reform*, 81 COLUM. L. REV. 261 (1981) (discussing shareholder derivative actions and urging reform); Steinberg, *The Use of Special Litigation Committees to Terminate Shareholder Derivative Suits*, 35 U. MIAMI L. REV. 1 (1980) (discussing special litigation committees appointed by the board of directors and proposing a corporate accountability standard).

47. 499 A.2d 1184 (Del. 1985).

48. *Id.* at 1192 (stating that "[p]roceeding to the second step . . . is wholly within the discretion of the [chancery] court").

49. *See* Aronson v. Lewis, 473 A.2d 805, 813 (Del. 1984) ("Under *Zapata* the [c]ourt of [c]hancery, in passing on a committee's motion to dismiss a derivative action in a demand excused case, must apply a two-step test.").

50. *Zapata*, 430 A.2d at 789. *See supra* note 45.

51. *See Kaplan*, 499 A.2d at 1192. *See supra* note 48.

52. *See* Ferrara & Steinberg, *supra* note 1, at 26 ("Thus, the next key issue

was excused because a majority of the directors were financially interested in the challenged transaction.[53] Only in demand-excusal cases does *Zapata*'s two-step test apply. Otherwise, the almost impregnable business judgment rule is the guiding principle.[54] Hence, on a practical basis, demand-excusal situations present the only claims that are normally worthwhile to pursue.

The Delaware high court settled this issue in *Aronson v. Lewis*.[55] In so doing, it confined *Zapata*'s scope in a fundamental way. The facts alleged in *Aronson* seemed to represent a good plaintiff's case. There, the controlling shareholder of the company, who was the corporation's founder and in his seventies, received, among other benefits, a lucrative consulting contract and a percentage of the corporation's profits if they exceeded a certain monetary amount. Compensation was not dependent upon the founder being able to work, even for a single day. In addition, the founder also received interest-free loans totalling $225,000, apparently with no business justification provided.[56] The members of the board who authorized the transactions were not financially interested in the particular transactions.[57]

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to surface in this context may well entail the circumstances under which demand on the board is excused.").

53. *See Zapata*, 430 A.2d at 780, 786-87. *See generally* Buxbaum, *Conflict-of-Interest Statutes and the Need for a Demand on Directors in Derivative Suits*, 68 CALIF. L. REV. 1122 (1980) (challenging current demand procedures as undermining conflict of interest statutes); Comment, *The Demand and Standing Requirements in Stockholder Derivative Actions*, 44 U. CHI. L. REV. 168 (1976) (analyzing the requirements of exhaustion of intracorporate remedies and standing to sue).

54. Generally, the business judgment rule is a presumption that a director or officer making a deliberative decision is reasonably informed, made reasonable inquiry, is acting in good faith without a disabling conflict of interest, and has a rational basis for the business decision made. *See Aronson*, 473 A.2d at 812 (gross negligence standard applied). *See generally* D. BLOCK, N. BARTON & S. RADIN, THE BUSINESS JUDGMENT RULE (2d ed. 1988); Arsht, *The Business Judgment Rule Revisited*, 8 HOFSTRA L. REV. 93 (1980) (defending the business judgment rule as a reasonable standard for assessing director conduct); Steinberg, *The American Law Institute's Draft Restatement on Corporate Governance: The Business Judgment Rule, Related Principles, and Some General Observations*, 37 U. MIAMI L. REV. 295 (1983) (exploring application of the business judgment rule in modern corporate practice).

55. 473 A.2d 805 (Del. 1984).

56. *Id.* at 808-09. *See id.* at 817 n.13 (citing DEL. CODE ANN. tit. 8, § 143 (1983) (granting a board broad discretion to authorize interest-free loans to any officer or employee where such loan "may reasonably be expected to benefit the corporation" but no explanation of benefit given by court).

57. *See Aronson*, 473 A.2d at 808-09.

The court in *Aronson* held that demand was required because the directors, other than the fiduciary receiving the benefits, were disinterested. According to the court, a director is interested for demand-excusal purposes if the complainant adequately shows by pleading specific facts that such director is financially interested, is controlled or dominated by a financially-interested fiduciary, or that the decision made is other than the product of an informed business judgment.[58] Applying the foregoing, the court held that the plaintiff had failed to allege through specific facts that the interested fiduciary controlled or dominated the other directors. That the directors' positions were dependent on the controlling shareholder's continued support was insufficient. Rather, specific facts of domination or control concerning the particular transaction(s) challenged must be set forth.[59] Given that minority shareholders' only access to corporate information at this stage is limited normally to inspection of the company's books and records,[60] receipt of financial reports,[61] and what is in the public domain (such as newspaper accounts), a shareholder's ability to allege the requisite facts is significantly impaired.

Moreover, if a situation cried out for an apparent lack of an informed business judgment by directors, this seemed to be such a scenario: a controlling shareholder receiving lucrative financial benefits, evidently disproportionate to the value of services to be rendered, and payment for such services being guaranteed irrespective of the controlling shareholder's ability to perform in a competent manner. Yet, the Delaware Supreme Court dismissed the allegations on this issue as being devoid of merit.[62]

Aronson's practical effect is to limit invocation of *Zapata*'s two-step test normally to instances where a majority of the board is

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58. *Id.* at 812-15. Demand is excused only where "under the particularized facts alleged, a reasonable doubt is created that: (1) the directors are disinterested and independent and (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." *Id.* at 814. *Accord* Grobow v. Perot, 539 A.2d 180 (Del. 1988).

59. *Aronson*, 473 A.2d at 815.

60. *See* DEL. CODE ANN. tit. 8, § 220 (1983).

61. *Id.* Moreover, if the corporation is subject to § 12(b), § 12(g), or § 15(d) of the Securities Exchange Act of 1934, then the shareholder will have access to financial and narrative information contained in documents that are required to be filed with the Securities and Exchange Commission (SEC). *See, e.g.*, Form 10-K, 17 C.F.R. § 249.310 (1989); Form 10-Q, 17 C.F.R. § 249.308a (1989); Form 8-K, 17 C.F.R. § 249.308 (1989).

62. *Aronson*, 473 A.2d at 814-18.

financially interested in the challenged transaction.[63] In many other situations, counsel, being paid on a contingency fee basis, would be imprudent to accept representation on behalf of a shareholder derivative claimant. Unless the transaction is patently egregious on its face, there is simply too slim a possibility of excusing demand. Hence, although *Zapata* at its inception gave rise to expectations that the shareholder derivative action in Delaware would retain its vitality, subsequent events have largely diminished those hopes.

C. *The Duty of Care*

Smith v. Van Gorkom[64] and its subsequent evisceration[65] by the Delaware legislature provide a third example of that state's neglect of shareholder interests. In *Van Gorkom*, experienced and reputable directors, who met for a two-hour board meeting relying largely on a twenty-minute oral presentation by the corporation's chief executive officer to authorize that a merger transaction at a substantial premium over the prevailing market price be recommended for shareholder approval, were held momentarily liable for breach of their duty of care.[66] A deluge of criticism followed.[67] If confined to the court's

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63. *See* STEINBERG, *supra* note 37, § 14.03[2]. Under *Aronson*, "[o]nly where a majority of the directors derive a personal financial benefit or are engaged in an 'interested director' transaction will demand normally be excused." *Id.* (citing *Aronson*, 473 A.2d at 815). *Accord* Block & Prussin, *Termination of Derivative Suits Against Directors on Business Judgment Grounds: From* Zapata *to* Aronson, 39 BUS. LAW. 1503, 1505-06 (1984). *See also* Cox & Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, 48 LAW & CONTEMP. PROBS. 83 (1983).

64. 488 A.2d 858 (Del. 1985).

65. *See infra* notes 69-75, 182-90 and accompanying text.

66. *See Van Gorkom*, 488 A.2d at 874, 881.

67. *See, e.g.*, Fischel, *The Business Judgment Rule and the* Trans Union *Case*, 40 BUS. LAW. 1437, 1455 (1985) ("one of the worst decisions in the history of corporate law"); Herzel & Katz, Smith v. Van Gorkom: *The Business of Judging Business Judgment*, 41 BUS. LAW. 1187, 1188 (1986) ("the court's decision seems misguided"); Manning, *Reflections and Practical Tips on Life in the Boardroom After* Van Gorkom, 41 BUS. LAW. 1, 1 (1985) ("the corporate bar generally views the decision as atrocious"); Herzel, Davis & Colling, *"Smith" Brings Whip Down on Directors' Backs*, Legal Times, May 13, 1985, at 14 ("dumbfounding"). Some commentators were supportive of the decision, or at least felt that it did not spell doom for directors. *See, e.g.*, Chittur, *The Corporate Director's Standard of Care: Past, Present, and Future*, 10 DEL. J. CORP. L. 505, 542 (1985) ("in tune with contemporary thinking"); Prickett, *An Explanation of* Trans Union *to "Henny-Penny" and Her Friends*, 10 DEL. J. CORP. L. 451, 462 (1985) ("the only justifiable result"); Schwartz & Wiles, Trans Union: *Neither "New" Law nor "Bad" Law*, 10 DEL. J. CORP. L. 429, 430 (1985) ("the case merely represents a reiteration of existing Delaware law").

application of the law to the particular facts of that case, such criticism may have been justified.

But what ensued was director relief legislation.[68] Proponents pointed to a purported insurance crisis[69] and to fears that outside directors would refuse to serve on corporate boards, thereby resulting in Delaware corporations lacking competent overseers to monitor management.[70] Even assuming that the above assertions had a firm basis in reality, the legislation enacted was far too broad, particularly in its inclusion of inside directors within the ambit of the statute.[71] Hence, under Delaware law today, a corporation's articles of incorporation may absolve a director from monetary liability for breach of the duty of care.[72] In such circumstances, lack of good faith must be shown.[73]

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68. *See infra* notes 69-75, 182-90 and accompanying text. *See also* Steinberg, *The Evisceration of the Duty of Care*, 42 Sw. L.J. 919, 920 (1988) (footnotes omitted):

> Shocked at the Delaware court's "chutzpah" in imposing liability where no self-dealing or other breach of the duty of loyalty existed, corporate fiduciaries and their counsel clamored for action. Delaware, wishing to retain its preeminent position as the state of incorporation for nearly half of the New York Stock Exchange listed companies, was accommodating. Within a few months, Delaware enacted legislation overturning *Van Gorkom*. Today, provided that an appropriate amendment is inserted into the articles of incorporation, directors are not monetarily liable unless they commit a breach of the duty of loyalty, declare an unlawful distribution, receive an improper personal benefit, or act in bad faith. Monetary liability in Delaware for "simple" gross negligence is a relic of the past.

69. *See, e.g.*, Herzel, Shepro & Katz, *Next-to-Last Word on Endangered Directors*, HARV. BUS. REV., Jan.-Feb. 1987, at 38; Mallen & Evans, *Surviving the Directors' and Officers' Liability Crisis: Insurance and the Alternatives*, 12 DEL. J. CORP. L. 439, 459-64 (1987).

70. *See, e.g.*, Block, Barton & Garfield, *Advising Directors on the D & O Insurance Crisis*, 14 SEC. REG. L.J. 130, 131-32 (1986); *Director Roundtable: The D & O Crisis and Board Liability*, Directors & Boards, Summer 1986, at 8, 9-10.

71. *See* Steinberg, *supra* note 68, at 924 ("Indeed, no convincing evidence exists suggesting that the insurance crisis has chilled the willingness of senior executives to embrace the benefits of their corporate status.").

72. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (1983 & Cum. Supp. 1988).

73. *Id. See supra* note 68. *See generally* Balotti & Gentile, *Elimination or Limitation of Director Liability for Delaware Corporations*, 12 DEL. J. CORP. L. 5 (1987) (discussing § 102(b)(7) of the Delaware General Corporation Law); Radin, *The Director's Duty of Care Three Years After* Smith v. Van Gorkom, 39 HASTINGS L.J. 707 (1988) (discussing statutes that limit director liability and duty of care decisions); Veasey, Finkelstein & Bigler, *Delaware Supports Directors With a Three-Legged Stool of Limited Liability, Indemnification, and Insurance*, 42 BUS. LAW. 399 (1987) (discussing Delaware's approach to director and officer protection from personal liability).

It may be asserted that, because the Delaware statute requires shareholder approval (*see* DEL. CODE ANN. tit. 8, § 102(b)(7) (1983 & Cum. Supp. 1988)), an

As I have elaborated upon in a prior publication[74] and which will be discussed later in this article,[75] Delaware's legislation is far more protective of shareholders than statutes passed by some other states. It represents a moderate approach, particularly in view of the then existing political realities.[76] Nevertheless, the legislation highlights that, when managers of Delaware corporations raise their ire and threaten to reincorporate elsewhere, legitimate shareholder interests will be sacrificed.

III. *PARAMOUNT* AND ITS RAMIFICATIONS

With the foregoing discussion in focus, the article will now turn to *Paramount*. The decision may be the most significant that the Delaware Supreme Court has ever handed down. It fundamentally affects corporate governance, delineating the expansive authority that boards of directors possess.[77] In establishing the parameters of this authority in the tender offer context, the Delaware high court sets forth boundaries that are all encompassing. Yet, the decision also

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amendment to the articles of incorporation limiting director monetary liability is consistent with principles of corporate accountability. In response to this contention, I have replied:

> [I]t may be asserted that the vast majority of these statutes are enabling in nature and, therefore, are fully in accord with principles of corporate accountability. The shareholders' contractual relationship with the corporation normally is altered in this context only after a majority of shares outstanding, being adequately informed of the advantages and detriments of such modification, vote to amend the articles of incorporation. Although this argument has certain appeal, its validity rings hollow in light of the realities of the corporate governance process. Meaningful shareholder consent in this context is an illusion given management's control of the proxy machinery process, the strong inclination of institutional investors to vote with management, and the typical individual stockholder's ignorance of corporate charter provisions. Indeed, because these charter amendments have the effect of frustrating a shareholder's legitimate expectations, they may be characterized as contracts of adhesion and, therefore, void. The leverage exerted by management, in any event, should call for the continued validity of these charter provisions to be subject to periodic ratification by the shareholders. For example, shareholder approval should be required every third year after such an amendment's initial passage.

Steinberg, *supra* note 68, at 927 (citations omitted). *See* Gelb, *Director Due Care Liability: An Assessment of the New Statutes*, 61 TEMPLE L. REV. 13 (1988).

74. *See* Steinberg, *supra* note 68, at 924-29.

75. *See infra* notes 182-90 and accompanying text.

76. *See* Steinberg, *supra* note 68, at 920-24; *infra* notes 182-90 and accompanying text.

77. *See Paramount*, 571 A.2d at 1150-55; *infra* notes 142-69 and accompanying text.

may be viewed as another saga in Delaware's quest to maintain its premier status as the state which corporate managers most prefer.

A. *The Facts*

Stated succinctly, after careful analysis the Time Board of Directors, comprised of a majority of outside directors,[78] believed it to be in Time's best interests to find a merger partner. This objective was thought necessary in order for Time to successfully market its entertainment products to their potential and to take advantage of synergies of markets, operation, and production. At the same time, the Time Board stressed that preserving the editorial independence of Time was essential to the consummation of any prospective transaction. The directors focused on a number of merger candidates, finally determining that Warner Communications would be the most suitable match.[79]

After initial discussions broke down, Time and Warner struck a deal. Warner would be merged into a subsidiary of Time, with Warner shareholders receiving Time stock. The corporation's name would become Time-Warner, Inc. After the merger's effectuation, former Warner shareholders would own approximately sixty-two percent of the outstanding stock. Control of the combined enterprise, with respect to the composition of the board of directors and key managerial positions, would be divided on a fairly equal basis between Time and Warner.[80] The merger was subject to approval by shareholders of both corporations. While approval by Warner shareholders was mandated by Delaware statute,[81] the Time shareholders' right to approve the transaction was provided by the rules of the New York Stock Exchange.[82]

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78. *Paramount*, 571 A.2d at 1143 (12 of the 16 directors were outside directors).

79. *Id.* at 1143-46. This independence was questioned in *Newsweek*:

> Last week's curious cover story in Time was about "Presumed Innocent" author Scott Turow, whose new book "The Burden of Proof" has received mixed reviews. The article offered lavish details about the upcoming movie version of "Presumed Innocent" but neglected to mention Warner Bros. made the movie. [A] Time spokeswoman . . . said the magazine did not have a responsibility to report the corporate connection and denied there was a conflict of interest . . . .

Time: No Conflict, Newsweek, June 18, 1990, at 2.

80. *Paramount*, 571 A.2d at 1145-46.

81. *Id.* at 1146.

82. *Id. See infra* notes 92-93 and accompanying text.

Certain lock-ups were part of the deal. These included an automatic share exchange agreement between Time and Warner that could be triggered by either party,[83] Time agreeing (at Warner's insistence) to a "no-shop" clause without a fiduciary-out exception,[84] and a "dry-up" agreement whereby Time would obtain "confidence" letters from various banks in which the banks would promise to refrain from financing any third-party bid to acquire Time.[85]

After the proxy statements were mailed but prior to the Time shareholder meeting, Paramount made an unsolicited cash tender offer for all Time shares at $175 cash. The Paramount offer was later raised to $200 cash per Time share. The offer was subject to certain conditions, including termination by Time of its merger and stock exchange agreements with Warner as well as the redemption of Time's poison pill.[86]

Without the outside directors retaining separate independent advisors, the Time Board rejected the Paramount offer. To fend off Paramount's bid, the Time Board restructured the Time-Warner deal so that Time would make a tender offer for Warner.[87] As a condition for agreeing to the transaction's restructuring, the Warner Board extracted further covenants from Time.[88] In addition, while the contemplated merger would not have caused either corporation to be saddled with debt, the restructuring would require Time to assume between $7 to $10 *billion* worth of debt.[89]

Paramount and shareholders of Time brought suit seeking a preliminary injunction to halt Time's tender offer. The chancery court ruled in favor of Time.[90] The supreme court affirmed.[91]

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83. *Paramount*, 571 A.2d at 1146.

84. *Id.* at 1146-47.

85. *Id.* at 1146. *See generally* Colli, London & Keefe, *Bust-Up Fees, Topping Fees, and Expense Reimbursements*, 22 REV. SEC. & COMM. REG. 77 (1989) (analyzing cases involving "no-shop" clauses and other "lock-up" measures); Helman & Davis, *Merger and Acquisition Agreements in Competitive Bidding Situations: Rights and Obligations Created by Corporation and Contract Law*, 17 SEC. REG. L.J. 3 (1989) (defining competitive bidding issues surrounding acquisition agreements).

86. *Paramount*, 571 A.2d at 1147-49. Other conditions to Paramount's offer included Paramount procuring to its satisfaction cable franchise transfers from Time, and a judicial determination that Delaware's antitakeover statute was inapplicable to a Time-Paramount merger. *Id.* at 1147.

87. *Id.* at 1147-48.

88. *Id.* at 1148 (including a control premium and "agreements that Time would not employ its poison pill against Warner and that, unless enjoined, Time would be legally bound to complete the transaction").

89. *Id. See infra* notes 162-64 and accompanying text (discussing this issue).

90. Paramount Communications, Inc. v. Time, Inc., No. 10,866 (Del. Ch.

Before delving into an analysis of the supreme court's opinion, a comment is in order. The court states that, in restructuring the transaction, the Time Board did not deprive the corporation's shareholders of any right that they had under Delaware law. Approval of the initially-planned merger by Time shareholders was mandated by the New York Stock Exchange, not Delaware law.[92] The court's statement is correct. Nonetheless, it is a poignant commentary on corporate governance that, in carrying out such a transaction, a board of directors can cause a subsidiary to be formed, have the partner to the transaction merged into the subsidiary, and thereby deny the corporation's shareholders their right to vote on such a fundamental issue directly impacting upon their economic interest. But for the rules of the New York Stock Exchange, if the merger had proceeded, former Warner shareholders would have owned sixty-two percent of Time-Warner without Time shareholders having a voice in the transaction.[93]

B. *Ramifications Upon* Revlon

In *MacAndrews & Forbes Holdings v. Revlon, Inc.*,[94] the Delaware Supreme Court held that, in situations where a company is to be broken up, the board of directors must seek to maximize immediate shareholder return. If an auction is necessary to effectuate this objective, it must be adequately conducted.[95] Favoring a particular bidder in this context can be justified only if such conduct rationally relates to achieving maximum value for shareholders.[96]

After *Revlon*, it was uncertain in which settings the board would have the duty to maximize immediate shareholder return which often

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July 14, 1989) (revised July 17, 1989), *reprinted in* 15 DEL. J. CORP. L. 700 (1990), *aff'd*, 571 A.2d 1140 (Del. 1990).

91. *Paramount*, 571 A.2d at 1155.

92. *Id.* at 1146.

93. *See* PRINCIPLES OF CORPORATE GOVERNANCE, *supra* note 29, § 6.01(b) (requiring shareholder approval of, *inter alia*, triangular statutory mergers).

94. 506 A.2d 173 (Del. 1986).

95. *See* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1988). *See also* Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53 (Del. 1989).

96. *Macmillan*, 559 A.2d at 1286-88; *Revlon*, 506 A.2d at 182. *See* Hanson Trust v. ML SCM Acquisition, Inc., 781 F.2d 264 (2d Cir. 1986) (applying New York law); Edelman v. Fruehauf Corp., [1986-1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,863 (6th Cir. 1986) (applying Michigan law); Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286-87 (Del. 1989).

encompasses the task of auctioning the company.[97] The Delaware Supreme Court, by narrowly construing *Revlon*'s scope, went a long way toward resolving this issue in *Paramount*. Without excluding other possibilities, the court enumerated two situations where *Revlon* duties may apply. "The first, and clearer one, is 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."[98] Second, "*Revlon* duties may also be triggered 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."[99]

Upon analysis, the court in *Paramount* held that *Revlon* duties were not implicated.[100] Hence, the adoption of "structural safety devices," such as lock-ups, no-shop clauses and dry-up agreements, are insufficient by themselves to trigger *Revlon*.[101] The same certainly can be said with respect to sale of a non-control block of stock to a white squire.[102] Moreover, a corporate restructuring does not come within *Revlon* provided that it does not amount to a bust-up.[103] Hence, as evidently interpreted in *Paramount*, *Revlon* duties do not turn on whether the company becomes more "takeover proof."[104]

Importantly, the court did not view the Time-Warner contemplated merger as a sale of Time. By seeking to engage in the merger, the Time Board of Directors was implementing a strategic plan that

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97. As the Delaware courts have held, maximizing immediate value to shareholders under *Revlon* does not necessarily entail the duty to auction. *See, e.g.*, Barkan v. Armsted Indus., Inc., 567 A.2d 1279 (Del. 1989); Braunschweiger v. American Home Shield Corp., No. 10,755 (Del. Ch. Oct. 26, 1989), *reprinted in* 15 DEL. J. CORP. L. 997 (1990); Pierce & Smith, *Delaware Clarifies Board's Duty to Maximize Shareholder Value*, Nat'l L.J., Apr. 23, 1990, at 24 (noting cases discussed therein).

98. *Paramount*, 571 A.2d at 1150 (citing Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1988)).

99. *Id.* In such circumstances, "[t]he duty of the board [has] thus changed from the preservation of [the] corporate entity to the maximization of the company's value at a sale for the stockholder's benefit." *Revlon*, 506 A.2d at 182.

100. *Paramount*, 571 A.2d at 1150-51.

101. *Id.* at 1151 ("The adoption of structural safety devices alone does not trigger *Revlon*." Rather, *Unocal* applies.).

102. *See* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987); Kleinhandler v. Borgia, No. 8334 (Del. Ch. July 7, 1989).

103. On the other hand, certain restructurings, such as a huge distribution to shareholders, may be equivalent to a bust-up, thereby triggering *Revlon*. *See* Block & Hoff, *Recapitalizations and Restructurings*, N.Y.L.J., May 14, 1987, at 5; Coffee, *Shareholders Versus Managers: The Strain in the Corporate Web*, 85 MICH. L. REV. 1 (1986).

104. *See Paramount*, 571 A.2d at 1151; Freund & Ward, *What's "In," "Out" in Takeovers in Wake of* Paramount v. Time, Nat'l L.J., Mar. 26, 1990, at 22, 23.

it perceived as being in the corporation's best interests.[105] Hence, corporate combinations, sales of certain assets, and other similar actions undertaken pursuant to a long-term corporate plan evidently do not implicate *Revlon*, even if such actions are implemented to thwart a hostile takeover bid.[106]

Nonetheless, *Revlon* duties should apply in at least the following situations. First, such duties are triggered when a corporation, by direction of its board of directors, puts itself up for sale. This may occur by the board initiating such a sale or in response to a hostile bid. Second, *Revlon* is invoked when the break-up of the company becomes inevitable. Such break-ups frequently occur in leveraged buy-out transactions, sponsored either by management or third parties.[107]

In corporate restructurings, the issue arises as to what percentage of assets must be disposed of in order for the company to be deemed "broken up," thus implicating *Revlon*. Rather than focusing on an inflexible percentage of assets affected, the better approach is to apply the rationale of *Gimbal v. Signal Companies, Inc.*[108] Although that case involved determining when a transaction constitutes the sale of substantially all assets, thereby requiring shareholder approval under Delaware law,[109] its rationale should apply in this context as well. Where the restructuring materially impacts both qualitatively[110] and quantitatively[111] on the fundamental characteristics of the corporation, then in effect the company is to be broken up. This standard should be deemed to be met in all cases where the "crown jewel"[112] is

105. *See Paramount* 571 A.2d at 1150-51, 1154-55.

106. *See id. See also* Freund & Ward, *supra* note 104, at 23.

107. *See* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1988); MacAndrews & Forbes Holdings v. Revlon, Inc., 506 A.2d 173 (Del. 1986). *See also* STEINBERG, *supra* note 37, § 11.08[2].

108. 316 A.2d 599 (Del. Ch.), *aff'd*, 316 A.2d 619 (Del. 1974).

109. *Gimbal*, 316 A.2d at 605, 607-08. The case also involved whether the sale price was "wholly inadequate compensation for the assets of Signal Oil," and hence outside the presumption of the business judgment rule. *Id.* at 608-09.

110. *Id.* at 607-08 (looking to the "character" of the restructuring, such as whether the restructuring goes to the heart of the corporation's identity).

111. *Id.* at 607 (generally looking at the company's revenues, pre-tax earnings, assets, and net worth).

112. The "crown jewel" generally is a corporation's most prized asset, the sale of which should be deemed qualitatively and quantitatively fundamental, hence calling for *Revlon* to be invoked. A corporation, of course, may not have one specific crown jewel but rather several "lesser" jewels. In such case, the sale of any one such jewel would be analyzed under the *Gimbal* standard as suggested herein.

sought to be sold. Application of the *Gimbal* standard would permit (other than in contemplated "crown jewel" dispositions), a flexible doctrinal analysis in order to discern the economic realities in a given situation.[113]

Revlon duties also should be invoked in any instance where incumbent management takes a substantial equity participation in connection with a takeover bid, even if management plans to operate the company as an ongoing concern. Phrased another way, by seeking to take the company private,[114] management induces the corporation to abandon its previously established strategic plan to achieve optimal long-term return for its public shareholders. By departing from this preconceived plan, management seeks to drastically alter the fundamental nature of the enterprise, hence signifying that the company in effect has put itself up for sale. As a result, *Revlon* duties are invoked.

Even if the Delaware courts were to agree with the above analysis, *Paramount*'s construction of *Revlon* remains troubling in an important respect. So long as a board of directors acts pursuant to a preconceived business plan that it deems to be in the corporation's best interest, the board, in response to a hostile takeover bid, may cause the corporation to engage in a transaction that causes key assets and even control to be transferred to the unaffiliated shareholders of another corporation. Such "showstopper" tactics that "stack the deck" and preclude shareholders from tendering their stock is troubling in any event and is particularly so when an unrealistic definition of a sale is applied. For example, where the target seeks to fend off an unfriendly bidder by making an exchange offer for the shares of a third corporation (whereby a majority of the shares after the transaction would be held by shareholders pre-

113. The chancery court's treatment of the sale of Signal Oil by Signal illustrates the benefits to be derived from utilization of this standard. *See Gimbal*, 316 A.2d at 607-08.

114. Generally, "[a] going-private transaction is a transaction or series of transactions instituted by the controlling shareholders [or by a nonmanagement group] of a publicly-held corporation and designed to eliminate or substantially reduce the corporation's outstanding equity, thereby returning the corporation to private ownership." Comment, *Regulating Going Private Transactions: SEC Rule 13e-3*, 80 COLUM. L. REV. 782 (1980). *See* DeMott, *Directors' Duties in Management Buyouts and Leveraged Recapitalizations*, 49 OHIO ST. L.J. 517 (1988); Hazen, *Management Buyouts and Corporate Governance Paradigms*, 25 WAKE FOREST L. REV. 1 (1990); Lowenstein, *Management Buyouts*, 85 COLUM. L. REV. 730 (1985); Morrissey, *Law, Ethics and the Leveraged Buyout*, 65 U. DET. L. REV. 403 (1988).

viously unaffiliated with the enterprise), a sale should be deemed to occur.[115] In this context, the shareholders' investment often has been fundamentally altered, both on a qualitative and quantitative basis. The corporation, for example, may be involved in different businesses, may have a revised governance structure, and may have assumed substantial levels of debt. Applying the rationale of *Gimbal*,[116] as well as the *de facto* merger doctrine adopted in jurisdictions outside of Delaware,[117] the economic realities are that a sale of the enterprise has transpired.

C. Unocal *Ramifications—The Making of a Cosmetic Level of Review*

In *Unocal Corp. v. Mesa Petroleum Co.*,[118] the Delaware Supreme Court adopted a modified version of the business judgment rule when assessing the legitimacy of tactics undertaken by the target's board of directors in the tender offer setting. Under this "intermediate"[119] level of review, prior to the invocation of the business judgment rule, the board must establish first that there were "reasonable grounds for believing that a danger to corporate policy and effectiveness existed"[120] and second that the action implemented was "reasonable in relation to the threat posed."[121] The court believed that adopting this level of review was necessary "[b]ecause of the omnipresent specter that a board may be acting primarily in its own interests . . . ."[122]

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115. Of course, the Delaware Supreme Court's decision in *Paramount* points to a different result, namely, that such an exchange offer would not be a "sale" within the meaning of *Revlon*. *See Paramount* 571 A.2d at 1150-51.

116. *See supra* notes 108-13 and accompanying text.

117. *See* R. CLARK, CORPORATE LAW § 10.7, at 458 (1986).

> The de facto merger doctrine refers to a set of case law principles to the effect that certain corporate transactions that are not mergers in the technical statutory sense will nonetheless be treated as functionally equivalent to them [signifying] that shareholders who otherwise would not have gotten appraisal rights do get them.

Id. The doctrine has been rejected in Delaware. *See* Hariton v. Arco Elecs., 182 A.2d 22 (Del. Ch. 1962), *aff'd*, 188 A.2d 123 (Del. 1963).

118. 493 A.2d 946 (Del. 1985).

119. *See, e.g.*, Gilson & Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247 (1989); Comment, *Judicial Review of Antitakeover Devices Employed in the Noncoercive Tender Offer Context: Making Sense of the* Unocal *Test*, 138 U. PA. L. REV. 225 (1989).

120. *Unocal*, 493 A.2d at 955.

121. *Id.*

122. *Id.* at 954.

As I predicted in a publication a few years ago, the *Unocal* standard "may well be of cosmetic value, having little substantive impact."[123] *Paramount* demonstrates that this prediction was an accurate one. As the court pointed out in *Paramount*, the board satisfies *Unocal*'s first part by showing good faith and reasonable investigation.[124] This showing is materially enhanced if the board is comprised of a majority of outside directors, as was the Time Board.[125] In holding that the Time Board satisfied this standard, the *Paramount* court construed *Unocal* in an expansive manner, causing it to resemble the "plain vanilla" business judgment rule.[126]

Indeed, provided that the board can show that it was acting in good faith and not dominated by motives of either entrenchment or self-interest, broad discretion is accorded to the board's judgment. Even though independent advisors were not retained by the outside directors, the Time Board met the *Unocal* standard.[127] In so holding, the court declined to focus upon the structural bias[128] dilemmas faced by outside directors and consultants of the corporation, including its counsel and investment bankers. As discussed elsewhere by this author,[129] these individuals have a strong personal incentive to maintain the enterprise as an ongoing entity, with their relationships to the enterprise remaining intact.[130] Failure to cogently address this

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123. *See* Steinberg, *Tender Offer Regulation: The Need for Reform*, 23 WAKE FOREST L. REV. 1, 15 (1988).

124. *See Paramount*, 571 A.2d at 1152; Moran v. Household Int'l, 500 A.2d 1346, 1356 (Del. 1985).

125. *See Paramount*, 571 A.2d at 1154; *Moran*, 500 A.2d at 1356.

126. *See* Mirvis, Time/Warner: *The Delaware Supreme Court Speaks*, 4 M & A Corp. Gov. L. Rep. No. 2 (Apr. 1990) ("The [*Paramount*] Court's *Unocal* analysis seems to reduce rather importantly the differences between that form of heightened judicial review and the plain vanilla business judgment rule test of good faith and due care.").

127. *See Paramount*, 571 A.2d at 1146-48, 1154.

128. Structural bias may be defined as "inherent prejudice . . . resulting from the composition and character of the board of directors." Note, *The Business Judgment Rule in Derivative Suits Against Directors*, 65 CORNELL L. REV. 600, 601 n.14 (1980). *See also* Clark v. Lomas & Nettleton Fin. Corp., 625 F.2d 49, 53-54 (5th Cir. 1980) (recognizing the problem of structural bias); Miller v. Register & Tribune Syndicate, 336 N.W.2d 709, 716-18 (Iowa 1983) (same); Note, *The Propriety of Judicial Deference to Corporate Boards of Directors*, 96 HARV. L. REV. 1894 (1983) (discussing at length the issue of structural bias).

129. *See* Steinberg, *Attorney Conflicts of Interest in Corporate Acquisitions*, 39 HASTINGS L.J. 579 (1988); Steinberg & Lindahl, *The New Law of Squeeze-Out Mergers*, 62 WASH. U.L.Q. 351, 393-403 (1984).

130. *See, e.g.*, Steinberg, *supra* note 129, at 592 ("[I]t is to . . . a law firm's financial benefit to devise successful legal strategies for implementation by subject corporations.").

fundamental issue results in longer paper trails, rather than the exercise of impartial and informed judgment.

Yet, the real "new" news conveyed by *Paramount* is the almost boundless discretion afforded to the board in determining whether a takeover bid constitutes a threat to corporate policy and effectiveness under *Unocal*'s first part and in assessing whether the defensive action taken was reasonable in relation to the danger posed under that decision's second prong.[131] Prior to *Paramount*, it was thought by many, including the Delaware Chancery Court,[132] that *Unocal*'s first part came into play generally in two situations: (1) a two-tier coercive offer[133] and (2) an all-cash, all-share offer at an inferior price.[134] Conversely, an all-cash, all-share offer at reasonable value[135] was not deemed by the chancery court to constitute a threat to corporate policy and effectiveness under *Unocal*.[136]

The Delaware Supreme Court in *Paramount* viewed *Unocal*'s first prong as affording the board far greater leeway, and disapproved of limiting *Unocal* to the two situations described above. Such a construction of *Unocal*, according to the Delaware high court, is unduly narrow and rigid.[137] Rather, *Unocal*'s flexibility permitted the Time Board to focus on other threats posed by the Paramount offer, namely, that:

> Time shareholders might elect to tender into Paramount's cash offer in ignorance or a mistaken belief of its strategic benefit which a business combination with Warner might produce. Moreover, Time viewed the conditions attached

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131. *See Paramount*, 571 A.2d at 1152-55; *infra* notes 132-69 and accompanying text.

132. *See, e.g.*, City Capital Assocs. v. Interco, Inc., 551 A.2d 787, 797 (Del. Ch. 1988).

133. *See Ivanhoe*, 535 A.2d at 1344; *Unocal*, 493 A.2d at 956.

134. *See, e.g.*, AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 112 (Del. Ch. 1986).

135. *Id.* at 113. *See* Grand Metro., PLC v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); City Capital Assocs. v. Interco, Inc., 551 A.2d 787 (Del. Ch. 1988).

136. *See* cases cited *supra* notes 134-35. *See, e.g.*, Gilson, *Just Say No to Whom?*, 25 WAKE FOREST L. REV. 121 (1990); Loewenstein, *Toward an Auction Market for Corporate Control and the Demise of the Business Judgment Rule*, 63 S. CAL. L. REV. 65 (1989); Prentice & Langmore, *Hostile Tender Offers and the "Nancy Reagan Defense": May Target Boards "Just Say No"? Should They be Allowed to?*, 15 DEL. J. CORP. L. 377 (1990); Note, *An Examination of a Board of Directors' Duty to Redeem the Rights Issued Pursuant to a Stockholder Rights Plan*, 14 DEL. J. CORP. L. 537 (1989); authorities cited *supra* notes 119, 123.

137. *See Paramount*, 571 A.2d at 1153.

> to Paramount's offer as introducing a degree of uncertainty that skewed a comparative analysis. Further, the timing of Paramount's offer to follow issuance of Time's proxy notice was viewed as arguably designed to upset, if not confuse, the Time shareholders' vote.[138]

The Delaware Supreme Court's holding makes clear that an all-cash offer for all-shares outstanding at a superb premium over market value can constitute a *Unocal* threat. This holding is contrary to Delaware Chancery Court decisions on this issue.[139] In setting forth this expansive interpretation, the Delaware high court stressed that it is the board, acting pursuant to its business judgment, that makes this assessment—not the chancery court.[140] And, in ascertaining whether a *Unocal* threat exists, a board of directors would be prudent to have in place a majority of outside directors, an investment banker providing valuation advice, a pre-existing long-term strategic business plan, and a lack of self-dealing and entrenchment motives by the incumbent corporate fiduciaries.[141]

A theme underlying *Paramount* is that directors, as the duly elected representatives of shareholders, have the duty to protect shareholders from folly. Indeed, according to the court, the board had the duty to protect shareholders from accepting a $200 cash offer due to the shareholders' ignorance of the long-term economic potential of the Time-Warner combination.[142] Needless to say, shareholders would rather do without such so-called protection. Today, Time-Warner stock is selling for $71.25 per share,[143] and there is a legitimate question of when the stock's price will approach that offered by Paramount.[144] To point to shareholder naivete as a *Unocal* threat

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138. *Id.*

139. *See* cases cited *supra* notes 134-35.

140. *See Paramount*, 571 A.2d at 1153-54.

141. *Id.* at 1153-55. Although no independent investment banker was obtained to advise the outside directors, this practice would help to preclude a successful challenge to the board's conduct. *See* Polk v. Good, 507 A.2d 531, 537 (Del. 1986); *Weinberger*, 457 A.2d at 706; Sealy Mattress Co. of N.J., Inc. v. Sealy, Inc., 532 A.2d 1324 (Del. Ch. 1987).

142. *See Paramount*, 571 A.2d at 1149, 1153.

143. *See New York Stock Exchange Composite Transactions*, Wall St. J., Sept. 28, 1990, at C5, col. 3.

144. *See* Landro, *Time Warner Had $51 Million Loss in First Quarter*, Wall St. J., Apr. 24, 1990, at B6, col. 3 (indicating loss attributed to the acquisition of Warner Communications, Inc.); Lenzner, *Time Warner's Quandary*, Dallas Morning News, May 14, 1990, at 1D, 8D ("Time Warner is losing money and its investors are up in arms because the company's stock hovers around $90 a share. [It] is not expected to turn a profit until 1993 . . . .").

belies economic reality. Indeed, many of Time's shareholders were institutional investors.[145] Even as to individual investors, the United States Supreme Court's decision in *Basic, Inc. v. Levinson*[146] stands in marked contrast wherein the Court declined to attribute to investors "a child-like simplicity."[147]

The Delaware Supreme Court's opinion thus will induce boards of directors to devise long-term strategic business plans. Such plans should draw on the expertise of corporate personnel and outside consultants, focusing on the corporation's objectives, principally from a long-term perspective. The plans should be comprehensive and detailed, with the outside directors meaningfully participating in their drafting and adoption.[148] It may be asserted that so long as such a plan has a rational basis for developing a beneficial corporate strategy, any takeover bid that significantly impinges upon the plan's effectuation poses a *Unocal* threat. This is so even if the bid offers a substantial premium over present market price.[149] A consequence, of course, will be the laying of even more detailed paper trails. Such plans will also promote full employment for corporate planners.[150] Moreover, to ensure that the requisite good faith and reasonable investigation of *Unocal*'s first step is met, a board would be wise to implement the procedural steps addressed above.[151]

The Delaware Supreme Court also held that the restructuring of the Time-Warner transaction complied with *Unocal*'s second step, namely, that the board's action was reasonable in relation to the

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145. *See* Samuelson, *The Entrenching of Management*, Wash. Post, Aug. 9, 1989, at 12 (stating that "[p]ension funds own a quarter of all common stocks").

146. 485 U.S. 224 (1988).

147. *Id.* at 234. *See* STEINBERG, *supra* note 37, § 2.03[5] (discussing disclosure of merger negotiations and citing authorities therein) (discussing *Basic*); Gabaldon, *The Disclosure of Preliminary Merger Negotiations as an Imperfect Paradigm of Rule 10b-5 Analysis*, 62 N.Y.U. L. REV. 1218 (1987) (same); Karjala, *A Coherent Approach to Misleading Corporate Announcements, Fraud, and Rule 10b-5*, 52 ALB. L. REV. 957 (1988) (same).

148. *Cf.* Block & Hoff, *The Emerging Role of Special Committees*, N.Y.L.J., June 15, 1989, at 5, col. 3 (stating that in a corporate control context "an effective mechanism for ensuring that director action will be upheld is the use of a special committee of disinterested directors acting on behalf of and with the full authority of the board in overseeing and controlling the decision-making process").

149. *See Paramount*, 571 A.2d at 1153.

150. *See* Freund & Ward, *supra* note 104, at 23. *See generally* Branson, *Intracorporate Process and the Avoidance of Director Liability*, 24 WAKE FOREST L. REV. 97 (1989) (proposing that the focus in fiduciary duty claims, particularly in Delaware, is on the elements of process and not the result).

151. *See supra* notes 141, 148-50 and accompanying text.

threat posed.[152] Even though the effect of these maneuvers was to preclude Paramount's offer for Time, the court concluded that the Time Board reasonably perceived the Paramount bid to constitute a significant threat to the contemplated Time-Warner combination and that Time's response was reasonable.[153] Hence, principles of corporate governance mandate that, in discharging its managerial duties, the board of directors must select time frames for the achievement of corporate goals.[154] Accordingly, "[d]irectors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy."[155]

By upholding the validity of Time's tender offer for Warner, the court, in practical effect, precluded Paramount from making its offer to Time shareholders.[156] Although Paramount theoretically can make an offer for the combined Time-Warner entity, the economic magnitude of such a transaction,[157] along with the presence of the Delaware antitakeover statute[158] and the difficulty of procuring the necessary financing,[159] makes such a bid in the foreseeable future highly unlikely. In supporting such showstopper tactics engaged in by the Time Board, the court found that under the facts presented the granting of a no-shop provision with a no fiduciary-out clause as well as the procurement of dry-up agreements were inoffensive.[160] Perhaps even more importantly, the court expansively viewed Time's incurrence of $7-10 billion of debt to finance the Warner acquisition as permissible since the board "could reasonably perceive the debt load not to be so injurious to the corporation as to jeopardize its well being."[161] Given the detrimental effect that this debt load has

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152. *See Paramount*, 571 A.2d at 1154-55.

153. *Id.* at 1153-55.

154. *Id.* at 1154.

155. *Id.*

156. The sheer economic magnitude of Paramount's purchasing Time-Warner, when considered in conjunction with the amount of debt that would be assumed, makes this statement evident. *See infra* notes 157-62 and accompanying text.

157. Time-Warner's $11 billion debt speaks for itself with respect to this issue. *See* Landro, *Warner Bros.' Success at Box Office Feeds its Global Ambitions*, Wall St. J., June 1, 1990, at A1, col. 6; *supra* note 156.

158. DEL. CODE ANN. tit. 8, § 203 (Supp. 1988). *See infra* notes 196-201 and accompanying text.

159. *See* Smith, *Storming the Barricades with a Proxy*, Wall St. J., May 10, 1990, at C1, col. 3 (lack of bank and junk-bond financing responsible in part for the decrease in takeovers).

160. *See Paramount*, 571 A.2d at 1146-47, 1151 n.15, 1154-55.

161. *Id.* at 1155.

had on Time-Warner and its shareholders,[162] the court's upholding of such conduct belies reality.

Hence, it is not surprising that Time shareholders did not view these actions to be in their corporation's or their own best interests.[163] It is troublesome that the Time Board took preclusive takeover maneuvers that prevented shareholders from accepting an all-cash offer for $200 per share and which also saddled Time with billions of dollars of debt. As I have developed elsewhere, absent compelling reasons set forth by the incumbent board that the bidder's offer is unfair to the corporation and its shareholders, shareholders ought to be entitled to tender their stock without being subject to such preclusive maneuvers.[164]

It may well be that the "Just Say No" defense has been endorsed by the Delaware Supreme Court in *Paramount*.[165] Provided that the target's board of directors has no disabling conflict of interest, is

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162. *See* authorities cited *supra* notes 144, 157. Indeed, as stated by Time Warner in its 1989 Annual Report:

> For 1989 Time Warner's financial results . . . show a net loss of $256 million or $4.34 per share. These results reflect Time Warner's 59.3 percent ownership of Warner Communications for the last five months of the year, a significant increase in interest expense due to the purchase of Warner common stock and the use of purchase accounting.

TIME WARNER, INC., 1989 ANNUAL REPORT 18 (1990).

163. *See, e.g.*, United Shareholders Association (USA), Advocate, *Delaware Court Moves Against Shareholders*, Apr. 1990, at 2 ("Time shareholders as a group are some $5 billion poorer than they would have been had they been allowed to act on the Paramount offer.").

164. *See, e.g.*, STEINBERG, *supra* note 37, § 11.08[4]; Lynch & Steinberg, *The Legitimacy of Defensive Tactics in Tender Offers*, 64 CORNELL L. REV. 901 (1979); Steinberg, *supra* note 123, at 29-39.

165. *See* Letter to Our Clients from Wachtell, Lipton, Rosen & Katz, "Paramount v. Time: A Landmark Opinion in Takeover Defense" (Feb. 28, 1990) (stating that "the [Delaware] Supreme Court's opinion makes clear that . . . a board of directors is entitled to 'just say no'—even in the face of an 'adequate' all-cash, any-and-all tender offer"). *But see Even After Time-Warner Decision "Just Say No" Isn't as Easy as it Sounds*, 22 Sec. Reg. & L. Rep. (BNA) 516 (1990) ("Joseph Flom, of Skadden, Arps, Slate, Meagher & Flom . . . said *Time-Warner* leaves open the question whether a company can just say no if doing so would take away all shareholder choice."). *See also Macmillan*, 559 A.2d at 1285 n.35.

> Circumstances may dictate that an offer be rebuffed, given the nature and timing of the offer; its legality, feasibility and effect on the corporation and the stockholders; the alternatives available and their effect on the various constituencies, particularly the stockholders; the company's long term strategic plans; and any special factors bearing on stockholder and public interests.

Id.

reasonably informed and has in place a pre-existing long-term rational business plan, the board, particularly if it is comprised of a majority of outside directors, may engage in certain "showstop" tactics to prevent a successful hostile offer.[166] Such tactics may include the refusal by an incumbent board to redeem a "poison pill," even in response to a substantial all-share, all-cash offer. Nonetheless, this issue remains open for the time being. As the *Paramount* chancery court stated in the decision below, a board's determination whether to redeem a poison pill "which by definition is a control mechanism and not a device with independent business purposes, may present distinctive considerations."[167]

The Delaware Supreme Court's recognition of the "Just Say No" defense in the context of poison pill redemptions would make a mockery of corporate governance principles. As stated by one source:

> [Delaware's] corporation law exists, not as an isolated body of rules and principles, but rather in a historical setting and as a part of a larger body of law premised upon shared values. To acknowledge that directors may employ the recent innovation of "poison pills" to deprive shareholders of the ability effectively to choose to accept a noncoercive offer, after the board has had a reasonable opportunity to explore or create alternatives, or attempt to negotiate on the shareholders' behalf, would, it seems to me, be so inconsistent with widely shared notions of appropriate corporate governance as to threaten to diminish the legitimacy and authority of our corporation law.[168]

The author of the foregoing is none other than Chancellor Allen of the Delaware Chancery Court. It can only be hoped that the Delaware Supreme Court will give due consideration to Chancellor Allen's cogent statement. Extension of the "Just Say No" defense to the poison pill context would severely diminish the making of hostile tender offers for Delaware corporations, leaving proxy contests as

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166. *See Paramount*, 571 A.2d at 1154-55.

167. *Paramount*, No. 10,866, slip op. at 77 n.22, *reprinted in* 15 DEL. J. CORP. L. at 749 n.22, *aff'd*, 571 A.2d 1140 (Del. 1990).

168. *City Capital Assocs.*, 551 A.2d at 799-800.

the only viable mechanism to oust incompetent incumbent management.[169]

IV. COMPARISON TO OTHER STATES

Although this article is critical of Delaware's neglect of shareholder interests, the fact remains that it is more protective of those interests than many other states. This leaves Delaware in the unenviable position that, if it declines to protect incumbent managerial interests, the state may relinquish its status as the premier state of incorporation. To illustrate the positions taken by a number of other states, a few examples will suffice.

In the cash-out merger area, a number of states, including California,[170] Connecticut,[171] and Minnesota,[172] hold that appraisal is a minority shareholder's sole remedy when challenging a merger's unfairness.[173] A breach of fiduciary duty action, such as that permitted under *Weinberger*,[174] normally cannot be invoked in these states.[175] Hence, although *Weinberger* and its progeny, as elaborated upon earlier,[176] are deficient in protecting the interests of minority shareholders, Delaware's approach, unlike other states, provides a plausible alternative to the appraisal remedy.

With respect to shareholder derivative suit litigation, even taking into account *Wyatt*'s and *Aronson*'s confinement of *Zapata*,[177] Delaware's approach represents middle ground. A few states, recognizing the structural bias prevalent in this setting, apply more rigorous standards in determining whether to grant a special litigation com-

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169. *See* Letter, *supra* note 165, at 3 ("[T]he near future will be seeing the prominent use of proxy and consent mechanisms as tools of corporate takeovers."); *infra* notes 208-14 and accompanying text.

170. *See* Steinberg v. Amplica, Inc., 42 Cal. 3d 1198, 729 P.2d 683, 233 Cal. Rptr. 249 (1983).

171. *See* Yanow v. Teal Indus., Inc., 178 Conn. 262, 422 A.2d 311 (1979).

172. *See* MINN. STAT. ANN. § 302A.601 & comment at 555 (West 1985).

173. Hence, in these states, absent fraud, illegality, or perhaps nondisclosure, appraisal is the exclusive remedy. *See supra* notes 170-72; *infra* note 174; STEINBERG, *supra* note 37, § 15.02[2] (discussing the manner in which various states treat minority shareholders who challenge the fairness of a cash-out merger).

174. *See supra* notes 21-38 and accompanying text.

175. An exception may exist where, relying on materially misleading information, a shareholder refrains from perfecting the appraisal remedy. *See Steinberg*, 42 Cal. 3d at 1214, 729 P.2d at 694, 233 Cal. Rptr. at 259.

176. *See supra* notes 21-38 and accompanying text.

177. *See supra* notes 39-63 and accompanying text.

mittee's recommendation to dismiss a derivative action.[178] Other courts also more expansively excuse the demand on director requirement as being futile.[179] In contrast, a number of other states apply the business judgment rule to a special litigation committee's determination to seek dismissal of a derivative suit.[180] In such cases, a court's role is solely to assess the committee's independence, good faith, and the adequacy of its investigation. Judicial scrutiny of the merits underlying the committee's decision is deemed beyond the court's purview.[181]

Delaware's enactment of legislation limiting director monetary liability for breach of the duty of care in the aftermath of *Van Gorkom*[182] also reflects a moderate approach in comparison to statutes adopted by other states. For example, Indiana applies its exculpatory provisions without requiring that the corporation's articles of incorporation authorize such a limitation on directors' duties.[183] Maryland, seeking to outdo its northern neighbor, permits articles of incorporation to eliminate monetary liability for duty of care violations except in cases of active and deliberate dishonesty.[184] Moreover, Maryland permits recovery for duty of loyalty claims only to the extent of the monetary value of the improper benefit received.[185] The Maryland statute applies to officers as well as directors.[186] As a final example, subject to certain exceptions, Virginia authorizes corporations, pursuant to their articles of incorporation, to eliminate monetary liability altogether for corporate directors.[187]

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178. *See, e.g.*, Miller v. Register & Tribune Syndicate, 336 N.W.2d 709 (Iowa 1983); Alford v. Shaw, 320 N.C. 465, 358 S.E.2d 323 (1987).

179. *See, e.g.*, Lewis v. Curtis, 671 F.2d 779 (3d Cir. 1982); Barr v. Wackman, 36 N.Y.2d 371, 368 N.Y.S.2d 497, 329 N.E.2d 180 (1975).

180. *See, e.g.*, Auerbach v. Bennett, 47 N.Y.2d 619, 419 N.Y.S.2d 920, 393 N.E.2d 994 (1979). *See also Changes in the Model Business Corporation Act—Amendments Pertaining to Derivative Proceedings*, 45 BUS. LAW. 1241, 1246-53 (1990) (discussing the dismissal provision of § 7.44 of the Model Act).

181. *Auerbach*, 47 N.Y.2d at 633, 419 N.Y.S.2d at 928, 393 N.E.2d at 1002-03.

182. *See supra* notes 64-76 and accompanying text.

183. IND. CODE ANN. § 23-1-35-1(e) (1989).

184. MD. CORPS. & ASS'NS CODE ANN. § 2-405.2 (Supp. 1989).

185. *Id.*

186. *Id. See Symposium on the Maryland Director and Officer Liability Statute*, 18 U. BALT. L. REV. 225 (1989) (discussing the Maryland statute).

187. VA. CODE ANN. §§ 13.1-692.1(A), (C) (1989). *See* Goolsby & Whitson, *Virginia's New Corporate Code*, 19 REV. SEC. & COMM. REG. 147, 154 (1986); Honabach, *All That Glitters: A Critique of the Revised Virginia Stock Corporation Act*, 12 J. CORP. L. 433 (1987).

The Delaware statute, by contrast, mandates that in order to benefit from such a provision it must be contained in the corporation's articles of incorporation, thereby requiring shareholder approval in cases of amendment. This statutory provision also preserves actions for breach of the duty of loyalty, provides for a "good faith" as well as a deliberate misconduct standard, and applies only to directors (and not officers).[188] Versions of the Delaware statute have been enacted by a majority of states.[189] The approach adopted, particularly when considered in light of extreme statutes such as Maryland's, may be viewed as a reasonable and necessary response by the Delaware Legislature to block what otherwise would have been the flock of corporate migration.[190]

Last, we come to the subject of tender offers. Delaware's approach today apparently is that of the business judgment rule. Although *Unocal* applies in theory, the *Paramount* court's invocation of that standard signifies that it often will be of only "cosmetic" relevance.[191] One exception is that when *Revlon* duties are triggered, the board must seek to maximize immediate shareholder value, frequently acting as an auctioneer to effectuate this objective.[192] As the court implied in *Paramount*, however, the circumstances where *Revlon* duties come into being are relatively rare.[193]

Hence, the business judgment rule appears to be the prevailing standard in Delaware to assess the legitimacy of defensive actions undertaken by a target corporation's board of directors. Certain precautions should be implemented by a board to help ensure that the rule's umbrella may be invoked, including that a majority of the board be comprised of outside directors, that the board have in place a rational long-term business plan, and that it is advised by impartial outside advisers, such as counsel and investment bankers.[194] Although the business judgment rule may apply in certain situations,

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188. *See* DEL. CODE ANN. tit. 8, § 102(b)(7) (Cum. Supp. 1988); Bradley & Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance*, 75 IOWA L. REV. 1 (1989); authorities cited *supra* note 73.

189. *See* Radin, *supra* note 73, at 747-48 (listing the specific states that have enacted legislation based on the Delaware statute).

190. *See* Steinberg, *supra* note 68, at 927-28.

191. *See supra* notes 123-26 and accompanying text.

192. *See supra* notes 94-96 and accompanying text.

193. *See supra* notes 97-106 and accompanying text.

194. *See supra* notes 141, 148-51 and accompanying text.

even absent implementation of the above procedural mechanisms,[195] prudence calls for these steps to be adopted.

The fact remains, however, that even after *Paramount*, Delaware's approach, when considered in conjunction with its antitakeover statute,[196] is less strident than that of certain other states.[197] Pennsylvania's reaction to hostile takeovers, for example, permits the board to invoke a broadly focused business judgment rule which includes the consideration of noninvestor interests,[198] legitimizes by statute "poison pill" type measures,[199] sterilizes the voting rights of certain large shareholders,[200] and mandates, subject to certain exceptions, that a twenty percent shareholder "give up any profits on target-company stock [it] sell[s] during the 18 months after becoming [a] controlling person[ ]."[201] Needless to say, today successful hostile tender offers are rare in Delaware; they are nearly extinct in Pennsylvania.[202]

Thus, Delaware is no province for shareholder protection but is no worse and is much better than a number of other states. The question thereupon arises what, if anything, ought to be done to address this situation.

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195. For example, the outside directors of Time did not retain independent outside advisers. *See Paramount*, 571 A.2d at 1147.

196. DEL. CODE ANN. tit. 8, § 203 (1983 & Cum. Supp. 1988). *See also* Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865 (1990).

197. *See, e.g.*, Amanda Acquisition Corp. v. Universal Foods Corp., 877 F.2d 496 (7th Cir. 1989) (upholding the constitutionality of the Wisconsin takeover statute). *See generally* Bradford, *Protecting Shareholders from Themselves? A Policy and Constitutional Review of a State Takeover Statute*, 67 NEB. L. REV. 459 (1988) (arguing against state takeover statutes and focusing on Nebraska legislation); Pinto, *The Constitution and the Market for Corporate Control: State Takeover Statutes After* CTS Corp., 29 WM. & MARY L. REV. 699 (1988) (discussing various state statutory takeover models); Romano, *The Political Economy of Takeover Statutes*, 73 VA. L. REV. 111 (1987) (discussing state takeover statutes with emphasis on the politics surrounding the Connecticut legislation).

198. *See* Act approved Apr. 27, 1990, Act No. 1990-36, § 4, 1990 Pa. Legis. Serv. 93, 96-98 (Purdon).

199. *See* PA. CONS. STAT. ANN. tit. 15, § 1525 (Purdon 1990).

200. *See* Act No. 1990-36, § 6, 1990 Pa. Legis. Serv. 105 (to be codified at 15 PA. CONS. STAT. § 2563(a)).

201. *Pa. Governor Signs Anti-Takeover Bill, Two Lawsuits Filed Challenging New Law*, 22 Sec. Reg. & L. Rep. (BNA) 686 (1990). *See* Act No. 1990-36, § 6, 1990 Pa. Legis. Serv. 113 (to be codified at 15 PA. CONS. STAT. § 2574); Goel, *Pennsylvania's New Anti-Takeover Law Fuels Controversy, Faces Fight in Court*, Wall St. J., Apr. 30, 1990, at A12, col. 5.

202. This statement applies, of course, so long as the subject corporations elect not to opt-out of the Pennsylvania statute.

V. SHAREHOLDER ACTIVISM—FILLING THE GAP

The above analysis leads inescapably to the conclusion that the states, including Delaware, will not protect legitimate shareholder interests if to do so would result in incumbent management ire and incorporation in another jurisdiction. Although calls have been made for congressional legislation requiring federal incorporation[203] or mandating federal minimum standards,[204] the passage of any such legislation is a remote possibility.

Decisions such as *Paramount* thus signify that shareholders are left on their own to fend for themselves. This is not surprising, given the attitude of state courts and legislatures. Fortunately, shareholders, including institutional holders, are finally perceiving that unfettered management discretion may be contrary to their corporations' interests, their economic welfare, and public policy concerns, such as the environment.[205] The shareholder-rights movement is now winning over converts who have economic resources. No longer can incumbent management depend upon institutional investors to support its course of action or to simply sell their holdings if displeased. Today, when in their economic interests, institutional investors will take issue with management and, if deemed appropriate, will publicly oppose management's stance.[206] Individual investors also are showing indications that they are finally fed up. The membership of the United Shareholders Association, for example, is steadily increasing, with a 1990 membership of 64,000 shareholders.[207]

As their platform, shareholders frequently are turning to the proxy mechanism, largely regulated by the Securities and Exchange

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203. *See, e.g.*, Nader, *The Case for Federal Chartering* in CORPORATE POWER IN AMERICA 67-93 (R. Nader & M. Green eds. 1973); Reuschlein, *Federalization—Design for Corporate Reform in a National Economy*, 91 U. PA. L. REV. 91 (1942); Schwartz, *Federal Chartering of Corporations: An Introduction*, 61 GEO. L.J. 71 (1972).

204. *See* Cary, *supra* note 7, at 700-01. *See also* Fiflis, *Of Lollipops and Law—A Proposal for a National Policy Concerning Tender Offer Defenses*, 19 U.C. DAVIS L. REV. 303 (1986) (arguing for § 14(e) of the Williams Act to regulate substantive defense mechanisms).

205. *See* Rappaport, *The Staying Power of the Public Corporation*, Harv. Bus. Rev., Jan.-Feb. 1990, at 96, 103 ("It is becoming more commonplace . . . for public and private pension funds to vote their shares against underperforming managements and unreasonable antitakeover charter provisions . . . .").

206. *Id. See* Smith, *supra* note 159, at C1, col. 4 (due to the decline in takeover activity, proxy contests are gaining support from institutional investors).

207. *See* Jones, *Letting Freedom Ring in Corporate America*, Dallas Morning News, Apr. 15, 1990, at 1H, 2H (asserting also that "[s]hareholders are revolting in record numbers this year against the companies in which they own stock"). *Id.* at 1H.

Commission (SEC). As a result of this regulation, shareholders may well perceive that they will receive a fair shake. No longer is the SEC's shareholder proposal rule[203] the sole province of publicly concerned individuals, public interest organizations and church groups. Indeed, during the 1990 proxy season, individual and institutional shareholders submitted a wide range of proposals, ranging from voting rights to antitakeover maneuvers. Subjects that were raised by the proposals included ensuring confidential voting, instituting cumulative voting, the impropriety of greenmail payments, the banning of golden parachutes, the opting out of the Delaware antitakeover statute, the repeal of "classified" boards having staggered terms, and the redeeming of poison pills.[209]

Linked with this activism is the resurgence of the proxy contest as a viable mechanism to oust incumbent management. Recent contests illustrate that institutional holders may side with the insurgents[210] and that, even if incumbent management fends off the challenge, significant concessions may have to be made.[211] To mount a successful proxy battle, however, takes enormous financial resources and commitment.[212] And, unlike a tender offer, a controlling equity stake in the enterprise does not normally follow.[213] Hence, it remains to be seen whether the proxy contest vehicle serves as an adequate corporate governance alternative to the hostile tender offer as a means to replace ineffectual incumbent management.[214]

VI. CONCLUSION

This article posits that *Paramount* is a poorly reasoned opinion. The decision neglects legitimate shareholder interests, articulating a

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208. Rule 14a-8, 17 C.F.R. § 240.14a-8 (1990). *See generally* Cane, *The Revised SEC Shareholder Proxy Proposal System: Attitudes, Results and Perspectives*, 11 J. CORP. L. 57 (1985) (discussing the tension between SEC restrictions on shareholder proxy proposals and court expansion of corporate rights under the first amendment); Ryan, *Rule 14a-8, Institutional Shareholder Proposals, and Corporate Democracy*, 23 GA. L. REV. 97 (1988) (discussing institutional investor Rule 14a-8 activism and other controversies surrounding the rule).

209. *See* Jones, *supra* note 207, at 2H.

210. *See* Smith, *supra* note 159, at C1, col. 4.

211. *Id.* at C1, col. 5.

212. *See generally* E. ARANOW & H. EINHORN, PROXY CONTESTS FOR CORPORATE CONTROL (1968) (discussing the legal and practical difficulties in corporate proxy contests).

213. *See* STEINBERG, *supra* note 37, § 11.01. *Cf.* Brown, *Changes in Offeror Strategies in Response to New Laws and Regulations*, 25 CASE W. RES. L. REV. 843, 866 (1978).

214. *See* Dent, *Toward Unifying Ownership and Control in the Public Corporation*,

corporate governance framework that is antithetical to accountability concerns. Yet, the decision also can be perceived as a continuation of Delaware's quest to placate a vital component of its clientele, namely, incumbent management. Faced with the specter of corporate migration and loss of key revenues, Delaware is willing to do what is necessary to maintain its status as the premier state of incorporation for publicly-held companies.

Delaware, however, is not alone. Other states have made it widely known that they are willing to accommodate incumbent management's wishes with even greater fervor. Such hospitality is seen not only in the tender offer area but extends to such fare as cash-out mergers, shareholder derivative suits, and limiting the liability of corporate fiduciaries. Therefore, in this light, Delaware's course of conduct may be viewed positively from a shareholder's perspective. The state does only what it needs to do to keep corporations incorporated in Delaware and does not "inordinately" infringe upon shareholder interests.

What these developments signify is that shareholders must fend for themselves. Recent developments, particularly the increase in shareholder activism, indicate that this reality is finally being recognized. Whether this activism will become more widespread and successful remains to be seen. In the foreseeable future, however, if meaningful corporate governance reforms are to be effectuated, shareholders frequently must look to themselves as the principal actors.

1989 WIS. L. REV. 881, 924 (proposing that "corporate funds for proxy solicitations [be granted] exclusively to a committee of the [corporation's] largest shareholders").