Comment

PARAMOUNT COMMUNICATIONS, INC. v. TIME INC.: A DECISION OF PARAMOUNT SIGNIFICANCE?

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I. INTRODUCTION

A corporation can utilize many defensive strategies to prevent a hostile takeover by an unfriendly acquiror. These antitakeover devices include, but are not limited to, supermajority voting requirements for certain types of corporate action, staggered terms for the board of directors, broad shareholder rights plans, and poison pills.[1] In addition, after a takeover attempt has emerged, a board

1. D. HOGG, THE PREDATOR AND THE PREDATEE 31 (1988). A supermajority voting requirement is a requirement that "a qualified majority of the shareholders (*e.g.*[,] 66 2/3% rather than a simple majority of 51%) approve any consolidation, merger, sale of assets or other similar transaction." *Id.* Staggered terms for the board of directors require a corporate raider to "wait for more than one year to control the board and hence the means of consolidating an acquisition." *Id.* Broad shareholder rights plans are designed to "assure shareholders that following acquisition of voting control by a raider, the remaining minority shareholders could not be bought out or forced out at a price less than that paid for the original voting control." *Id.* Poison pills take many forms and are considered a lethal antitakeover

of directors may approve a restructuring or merger of the target corporation to discourage the hostile takeover from being effectuated.[2] Each of these defense mechanisms has the effect of providing a target corporation's board of directors with a degree of control over the fate of the corporation when confronted with a takeover attempt.[3]

As a result of the implementation of these defensive strategies, the courts must often resolve the issue of whether a target corporation's board of directors has breached its fiduciary duty to shareholders by either adopting, or allowing to remain in place, defense mechanisms which may thwart a hostile takeover.[4] In *Paramount Communications, Inc. v. Time Inc.*,[5] the Delaware Supreme Court decided that the restructuring of a preexisting merger transaction by Time Inc. (Time), approved as a defensive reaction to a tender offer made by Paramount Communications, Inc. (Paramount), was not a breach of the directors' fiduciary duty to shareholders.

The first issue the court addressed was whether the Time Board, by entering into a proposed merger with Warner Communications, Inc. (Warner), was under a duty to maximize current share values.[6] The court held that the board was not under a duty to maximize current share values because the initial merger agreement did not make the sale, dissolution, or break-up of Time inevitable.[7] A related issue that the court addressed was whether the board, by restructuring the initial merger agreement, was under a duty to maximize current share values.[8] With respect to this issue, the court concluded that the board was not under a duty to maximize short-term values as

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weapon. *Id.* For example, poison pill plans may give shareholders "favorably priced rights to stock in the acquiring company, or [give] shareholders the right to put their shares at favorable prices to the corporation in the event of a raid or threatened raid." *Id.*

2. *See, e.g.*, Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988) (management-sponsored plan involving sale of assets in response to tender offer); Robert M. Bass Group, Inc. v. Evans, 552 A.2d 1227 (Del. Ch. 1988) (management-sponsored restructuring in response to takeover offer), *rev'd sub nom.* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1988); City Capital Assocs. Ltd. v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988) (proposed restructuring involving sale of corporate assets in response to tender offer); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986) (recapitalization plan implemented in response to a tender offer).

3. HOGG, *supra* note 1, at 31.

4. *Id.*

5. 571 A.2d 1140 (Del. 1989).

6. *Id.* at 1150.

7. *Id.*

8. *Id.* at 1151.

Time neither abandoned its corporate goals nor made a sale of the corporation inevitable.[9]

Finally, the court addressed the question of whether the restructuring of the initial merger agreement was a valid response to the hostile tender offer.[10] The court upheld the defensive restructuring of the initial merger agreement as a reasonable reaction to the threat that Paramount's offer posed to Time's corporate strategy.[11]

This comment will first discuss the standard of review generally applied when decisions reached by a Delaware corporation's board of directors are challenged, the enhanced standard of review applied to defensive decisions made in response to a hostile takeover attempt, and the standard applied when a sale of the company is imminent. Second, this comment will provide a summary of the events leading to Time's rejection of the Paramount tender offer, and then analyze both the chancery and supreme courts' decisions to uphold the challenged transaction. The evaluation will focus primarily upon the supreme court's application of *Unocal*[12] in determining that the defensive measures taken were reasonable in response to the Paramount tender offer. Thereafter, it will discuss how the *Paramount* decision serves to limit the scope of previous chancery court decisions which have invalidated defensive actions taken in response to all-shares, all-cash tender offers because they were unreasonable in relation to the threat posed.

II. BACKGROUND

The board of directors of a Delaware corporation is charged by statute with the duty to manage the business and affairs of the corporation.[13] As a result of this power vested in the directors, they

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9. *Id.*

10. *Id.* at 1154.

11. *Id.* at 1155.

12. Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985). In *Unocal*, the Delaware Supreme Court articulated the standard of review applicable to the actions taken by a board of directors when confronted with a takeover attempt. *See infra* note 24 (discussing the pertinent facts and holding of the case).

13. DEL. CODE ANN. tit. 8, § 141(a) (1983) provides in pertinent part:

> (a) The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation. If any such provision is made in the certificate of incorporation, the powers and duties conferred or imposed upon the board of directors by this chapter shall be exercised or performed to such extent and by person or persons as shall be provided in the certificate of incorporation.

have an unyielding fiduciary obligation of care and loyalty to the corporation and its shareholders.[14] When directors are challenged for breaching these duties, the business judgment rule may be invoked "to protect and promote the full and free exercise of the managerial power granted to Delaware directors."[15] The business judgment rule is a "presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[16] The business judgment rule can only protect directors who are informed of all material information reasonably available to them prior to the making of a decision.[17] When the business judgment rule is applicable, the court will not substitute its own judgment for that of the board.[18] However, when Delaware

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14. Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (citing Loft, Inc. v. Guth, 2 A.2d 225 (Del. Ch. 1938), *aff'd* 5 A.2d 503 (Del. 1939)). *See also* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987). In *Ivanhoe*, the court described the directors' duty of care as: "requir[ing] a director, when making a business decision, to proceed with a 'critical eye' by acting in an informed and deliberate manner respecting the corporate merits of an issue before the board." *Id.* at 1345 (citations omitted). The court described the duty of loyalty as: "an affirmative duty to protect the interests of the corporation, but also an obligation to refrain from conduct which would injure the corporation and its stockholders or deprive them of profit or advantage. In short, directors must eschew any conflict between duty and self-interest." *Id.* (citations omitted).

15. *Smith*, 488 A.2d at 872 (citing Zapata Corp. v. Maldonado, 430 A.2d 779, 782 (Del. 1981)). The Delaware Supreme Court has described the business judgment rule as "an acknowledgement of the managerial prerogatives of Delaware directors under Section 141(a)." Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984). *Accord* Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981). In *Zapata*, the court stated that the business judgment rule "evolved to give recognition and deference to directors' business expertise when exercising their managerial power under § 141(a)." *Id.* at 782 . *See also supra* note 13 (pertinent portions of DEL. CODE ANN. tit. 8, § 141(a) (1983)).

16. *Aronson*, 473 A.2d at 812 (citations omitted). In *Aronson*, the court also defined the applicable standard of care as: "under the business judgment rule director liability is predicated upon concepts of gross negligence." *Id.* (footnote omitted).

17. *Smith*, 488 A.2d at 872 (footnote omitted). In *Smith*, the directors breached their duty of care by not making a reasonable inquiry before voting to "sell" the company for $55 per share pursuant to a cash-out merger and, therefore, were not accorded the protection of the business judgment rule. *Id.* at 874.

18. Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971) ("A board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose. A court under such circumstances will not substitute its own notions of what is or is not sound business judgment.").

directors are reacting to a hostile takeover attempt, their decisions are reviewed under an enhanced standard.

A. *Takeover Defenses and the Standard of Review*

When the shareholders of a target corporation are exposed to a cash tender offer, they generally have an opportunity to sell their shares at a premium over the market price.[19] Although shareholders may benefit by selling their shares at a premium to the potential acquiror in a cash tender offer, the management of the target corporation may oppose such a shift in control, and take defensive measures to avoid allowing the corporation to become the victim of an unwanted takeover attempt.[20]

As a result of the adoption of these defensive tactics, the courts are often required to address the issue of whether management has breached its fiduciary duty to the shareholders by not allowing them to maximize the value of their return by tendering shares to the acquiror. Courts in general have freely applied the business judgment rule to situations where management has employed a defensive strategy in opposition to a hostile tender offer,[21] and have held that "directors have not only the right but also the duty to resist tender offers that they believe to be not in the best interests of their shareholders."[22]

In *Unocal Corp. v. Mesa Petroleum Co.*,[23] the Delaware Supreme Court said that, because of the conflicting interests of the management of a corporation and its shareholders in the context of a takeover attempt, two prerequisites are imposed upon directors before they

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19. Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1165 (1981).

20. *Id.* at 1161. The motivation behind avoiding such a transaction when it appears to be in the best interests of the shareholders is the fear that a successful takeover attempt will result in the replacement of incumbent management. *Id.* at 1175.

21. *Id.* at 1198. The rationale behind the application of the business judgment rule, and the corresponding deference accorded management, is the concept that evaluating the economic merits of any transaction confronting a corporation is "peculiarly within the ability of management." *Id.* at 1194.

22. *Id.* at 1194. Easterbrook and Fischel adopt the view that management should be passive and acquiesce when faced with a tender offer and also propose that a challenged decision to block a tender offer should never be protected by the business judgment rule. *See id.* at 1194-204.

23. 493 A.2d 946 (Del. 1985).

have the protection of the business judgment rule.[24] First, the directors are required to show "that they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed . . . ."[25] This burden is satisfied "'by showing good faith and reasonable investigation . . . .'"[26]

Second, the defensive measure "must be reasonable in relation to the threat posed."[27] This prong requires the directors to evaluate the nature of the hostile bid and its resulting effect on the corporate entity.[28] Among the factors that the board may consider in its evaluation are the price, structure, and timing of the offer and its effect on non-stockholder groups such as employees and creditors.[29] If the two prongs of *Unocal* are satisfied, then the business judgment rule will be invoked to protect a takeover defense mechanism adopted by a board. Due to the nature of the analysis required by *Unocal*, the result of the inquiry will turn on the specific facts of each case.

It should be noted that the Delaware courts have applied the *Unocal* proportionality test with a degree of caution[30] for fear that

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24. In *Unocal*, the court articulated the conflicting interests of management and the shareholders when a takeover attempt is pending by stating that there is an "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders . . . ." *Id.* at 954.

In *Unocal*, a minority shareholder, Mesa Petroleum Company (of which the president and chairman of the board was T. Boone Pickens, Jr.) made a two-tier, "front-loaded" tender offer for 64 million shares of Unocal stock for $54 per share. *Id.* at 949. The remaining shareholders were to receive highly subordinated securities ("junk bonds") supposedly worth $54 per share. *Id.* at 949-50. Unocal's Board of Directors considered the offer coercive and inadequate and subsequently approved a self-tender which excluded Mesa Petroleum. *Id.* at 950-51. The supreme court held that the Unocal Board acted in good faith and in an informed manner in concluding that the Mesa Petroleum offer was inadequate as well as coercive. *Id.* at 949. The court also found that the self-tender which excluded Mesa Petroleum was a reasonable reaction to the threat posed. *Id.* Therefore, the Unocal Board was afforded the protection of the business judgment rule. *Id.*

25. *Id.* at 955 (citation omitted).

26. *Id.* (quoting Cheff v. Mathes, 199 A.2d 548, 555 (Del. 1964)). In addition, where a defensive measure is approved by a majority of outside, independent directors, proof of "good faith and reasonable investigation" is "materially enhanced." *Id. See also* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1356 (Del. 1985) (citing *Unocal*, 493 A.2d at 955; *Aronson*, 473 A.2d at 815) (stating that where a board is composed of a majority of outside directors, proof of good faith and reasonable investigation is materially enhanced).

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

28. *Id.*

29. *Id.* In *Macmillan*, 559 A.2d at 1282 n.29, the supreme court stated that other constituencies may be considered in evaluating a hostile offer provided that "it bears some reasonable relationship to general shareholder interests." *Id.*

30. City Capital Assocs. Ltd. v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988).

the court may be too inclined to impose its own preferences regarding a decision made by a board of directors, thereby diminishing the benefits provided by the business judgment rule.[31]

B. *A Change in Control and the* Revlon *Auction Rule*

The *Unocal* analysis is applied to board decisions made in response to a takeover threat in order to preserve important corporate policies, but the Delaware Supreme Court has held that once the directors decide to engage in a sale of the corporation, the board's duty to shareholders and the applicable standard of review become more stringent.[32] While a broad duty to maximize long-term share values is said to be imposed on the directors in managing the affairs of a corporation, this duty narrows when the board pursues a sale of the corporation that may serve to sever the interests of the existing shareholders.[33] As there is, in effect, no long term for the shareholders in a sale situation, the board's duty becomes one of maximizing current share values.[34]

The duty imposed on a board of directors to achieve the highest price for the benefit of its shareholders is known as the *Revlon* auction rule.[35] When the *Revlon* rule applies, directors' concerns which relate

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In *Interco*, the court noted that only two cases concluded that a defensive measure was a disproportionate response to the takeover threat presented. *Id.* at 796 n.9 (citing Robert M. Bass Group, Inc. v. Evans, 552 A.2d 1227 (Del. Ch. 1988); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986)). Since *Interco*, the court in *Pillsbury*, 558 A.2d at 1060, found a decision not to redeem a poison pill an unreasonable reaction to a noncoercive tender offer.

31. Paramount Communications, Inc. v. Time Inc., No. 10,866, slip op. at 75 (Del. Ch. July 14, 1989) (revised July 17, 1989), *reprinted in* 15 DEL. J. CORP. L. 700, 748 (1990) (citing *Interco*, 551 A.2d at 796).

32. TW Servs., Inc. v. SWT Acquisition Corp., Nos. 10,427 & 10,298, slip op. at 19 (Del. Ch. Mar. 2, 1989), *reprinted in* 14 DEL. J. CORP. L. 1169, 1183 (1989).

33. *Id.*, *reprinted in* 14 DEL. J. CORP. L. at 1183.

34. *Id.*, slip op. at 20, *reprinted in* 14 DEL. J. CORP. L. at 1184.

35. In Revlon v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986), the court held that when it became clear that the sale of the company was to occur, the board's concerns under *Unocal* were "significantly altered," and the directors were under a duty to ensure that the shareholders received the best price for their shares. *Id.* at 182. The judicial statement of the rule is as follows: "[W]hen 'the breakup of [a] company [is] inevitable[,] [t]he duty of the board . . . change[s] from the preservation of [the company] as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit.'" *Ivanhoe Partners*, 535 A.2d at 1344 (quoting *Revlon*, 506 A.2d at 182).

to the "corporation as a distinct legal entity become attenuated,"[36] and the directors are considered to be "in a radically altered state."[37] Furthermore, when the *Revlon* rule applies, "[q]uestions of defensive measures [become] moot" and "the directors' role change[s] from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."[38]

While the *Revlon* auction rule is generally triggered when the board makes the decision to effect a change in control transaction,[39] the Delaware Supreme Court has specifically stated that the *Revlon* duties also are imposed upon a board whether the break-up or the sale of the company is in the form of "an active auction, a management buyout, or a 'restructuring' . . . ."[40] It would follow, therefore, that the board does not have to expressly commit to selling the corporation before the strict duties imposed by the *Revlon* auction rule will be held applicable to its conduct.[41]

As a result of this construction of the *Revlon* rule, both the chancery and the supreme courts in *Paramount* were asked to determine

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36. *TW Servs.*, Nos. 10,427 & 10,298, slip op. at 21 (footnote omitted), *reprinted in* 14 DEL. J. CORP. L. at 1185.

37. *Id.*, slip op. at 22, *reprinted in* 14 DEL. J. CORP. L. at 1185.

38. *Revlon*, 506 A.2d at 182. In *Macmillan*, the supreme court described the proper role of *Unocal* when a board is conducting a sale of the corporation. The court stated that:

> [a]lthough the board's *responsibilities* under *Unocal* are far different, the enhanced *duties* of the directors in responding to a potential shift in control, recognized in *Unocal*, remain unchanged. This principle pervades *Revlon*, and when directors conclude that an auction is appropriate, the standard by which their ensuing actions will be judged continues to be the enhanced duty imposed by this Court in *Unocal*.

Macmillan, 559 A.2d at 1287 (footnote omitted).

39. *Paramount*, No. 10,866, slip op. at 51, *reprinted in* 15 DEL. J. CORP. L. at 734 (citing Mills Acquisition Co. v. Macmillan, Inc. No. 10,168 (Del. Ch. Oct. 17, 1988) (revised Oct. 18, 1988), *reprinted in* 14 DEL. J. CORP. L. 772 (1989), *rev'd on other grounds*, 559 A.2d 1261 (Del. 1988); *In re* RJR Nabisco, Inc. Shareholders Litig., No. 10,389 (Del. Ch. Jan. 31, 1989); *In re* J.P. Stevens & Co. Shareholders Litig., 542 A.2d 770 (Del. Ch. 1988); *In re* Holly Farms Corp. Shareholders Litig., No. 10,350, slip op. at 12 (Del. Ch. Dec. 30, 1988); *In re* Fort Howard Corp. Shareholders Litig., No. 9991 (Del. Ch. Aug. 18, 1988), *reprinted in* 14 DEL. J. CORP. L. 699 (1988)).

40. *Macmillan*, 559 A.2d at 1285. It should be noted that the state supreme court has also stated that "[c]learly not *every* offer or transaction affecting the corporate structure invokes the *Revlon* duties." *Id.* at 1285 n.35 (emphasis added). *See, e.g.*, Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987) (holding that directors had duty to resist coercive tender offer and *Revlon* duties not implicated).

41. *Paramount*, No. 10,866, slip op. at 57, *reprinted in* 15 DEL. J. CORP. L. at 738.

whether the Time directors had entered the *Revlon* zone when they decided to approve the original merger agreement with Warner and, therefore, were under a duty to maximize present share values.[42] After finding that the board of directors of Time had not triggered the duties imposed by the *Revlon* rule, each court proceeded to analyze the board's decision to reformat the Time-Warner merger agreement by applying the enhanced *Unocal* standard of review.[43]

III. ANALYSIS

In holding that the Time directors did not assume the duties imposed by the *Revlon* auction rule[44] and that the board's decision to restructure the merger satisfied the mandate of *Unocal*,[45] each court focused on the timing, structure, nature, and purpose of the merger agreements. To understand the reasoning of each court, a detailed review of the case is required.

A. *The Facts*

The defendant, Time, a Delaware corporation, is engaged in the business of publishing books and magazines, producing pay television programming, and owning and operating cable television franchises.[46] The Time Board is composed of four interested directors and eight "outside" directors.[47]

While Time's traditional business was founded upon its publishing activities,[48] the company had expanded its corporate mission to include mass media entertainment.[49] As a result of entering the

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42. *Paramount*, 571 A.2d at 1142; *Paramount*, No. 10,866, slip op. at 54, *reprinted in* 15 DEL. J. CORP. L. at 736.

43. *Paramount*, 571 A.2d at 1151; *Paramount*, No. 10,866, slip op. at 63, *reprinted in* 15 DEL. J. CORP. L. at 741.

44. *Paramount*, No. 10,866, slip op. at 75, *reprinted in* 15 DEL. J. CORP. L. at 748.

45. *Id.*, slip op. at 76, *reprinted in* 15 DEL. J. CORP. L. at 749.

46. *Id.*, slip op. at 5, *reprinted in* 15 DEL. J. CORP. L. at 709.

47. *Id.*, slip op. at 6, *reprinted in* 15 DEL. J. CORP. L. at 709-10. The four interested directors were officers of Time. The remaining eight directors did not hold officer positions with the corporation and, therefore, were considered "outside" directors. *Id.* Initially, Time's Board was comprised of 16 directors: 12 outside directors and 4 inside directors. Four outside directors, who were involved in the board decisions in question, resigned prior to this litigation. *See infra* note 106 (discussing the resignations of the four outside directors).

48. *Id.*, slip op. at 5, 8, *reprinted in* 15 DEL. J. CORP. L. at 709-10.

49. *Id.*, slip op. at 8, *reprinted in* 15 DEL. J. CORP. L. at 710.

mass media arena through video, the corporation relied upon this facet of its business to contribute to its income and growth.[50] In order to remain successful in this area, Time's executive board, as early as 1983, deemed it important to address the need to actually create, as well as own, the films and videos it provides through its cable operations.[51] The board also recognized the movement toward a "deeply interrelated global economy,"[52] and therefore, the directors considered the expansion of Time into the global markets to be a critical long-term business goal.[53]

Overriding these corporate strategies, however, was the desire of management and the board to maintain Time's independence and unique corporate culture.[54] This culture was described as both a managerial philosophy and a structure designed to preserve the corporation's journalistic integrity from the business side of the company.[55] Therefore, as is common among American corporations today, the board had taken the usual defensive measures to prevent a takeover attempt by an unwelcome suitor.[56]

As early as 1987, senior management of Time informed the board that they were involved in discussions with Warner regarding a joint venture that would enable Time to pursue its dual objectives

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50. *Id.* The chancery court also noted that the corporation's publishing activities remain critical to the enterprise. *Id.*, slip op. at 9, *reprinted in* 15 DEL. J. CORP. L. at 711. In addition, the court noted that these activities amount to 20% of all revenues produced by the country's magazine industry, and in excess of one-third of the profits. *Id.*, slip op. at 8 n.4., *reprinted in* 15 DEL. J. CORP. L. at 710 n.4.

51. *Paramount*, 571 A.2d at 1143; *Paramount*, No. 10,866, slip op. at 8-9, *reprinted in* 15 DEL. J. CORP. L. at 710-11.

52. *Paramount*, No. 10,866, slip op. at 9, *reprinted in* 15 DEL. J. CORP. L. at 711.

53. *Id.* In 1987, with all of these concerns in mind, a special executive committee was created to address and propose potential corporate strategies for the 1990s. *Paramount*, 571 A.2d at 1143.

54. *Paramount*, No. 10,866, slip op. at 9-10, *reprinted in* 15 DEL. J. CORP. L. at 711. The chancery court also noted that "there has never been the slightest subjective interest in selling to or submerging Time into another entity." *Id.*, slip op. at 11, *reprinted in* 15 DEL. J. CORP. L. at 712.

55. *Id.*, slip op. at 10, *reprinted in* 15 DEL. J. CORP. L. at 711.

56. *Id.*, slip op. at 11, *reprinted in* 15 DEL. J. CORP. L. at 712. The defensive measures implemented by the corporation included a staggered board, shareholder consent action restrictions, and a poison pill preferred stock rights plan which would trigger upon acquisition of 15% of the company. *Id. See supra* note 1 (discussing generally staggered boards and poison pills as antitakeover measures).

of video production capacity and access to global markets.[57] At the July 1988 board meeting, the directors were informed that management was then considering a consolidation with a "studio," and that Warner was the preferred candidate to most effectively achieve the corporation's objectives.[58] While the board did not adopt a resolution on the merger, it did approve the negotiation of a merger agreement.[59] However, this approval was contingent upon Time's management controlling the merged entity.[60] At the time of the board meeting, there was a proposed plan for co-chief executive officers (one from each organization), ultimately to be succeeded by one chief executive officer from Time.[61]

In addition, the plan called for a twenty-four member board composed of twelve Time directors and twelve Warner directors, with the requirement of a two-thirds vote to alter the board committee structure to whom Time's editor-in-chief would directly report.[62] The board was also advised that Warner would require the transaction to be in the form of a "stock for stock deal."[63] Based upon the board's encouragement, management was given the approval to pro-

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57. *Paramount*, No. 10,866, slip op. at 11-12, *reprinted in* 15 DEL. J. CORP. L. at 712. Three of the four outside directors were "encouraging" about such a joint venture. *Id.*, slip op. at 12, *reprinted in* 15 DEL. J. CORP. L. at 712.

58. *Id.*, slip op. at 13, *reprinted in* 15 DEL. J. CORP. L. at 713. Time's management investigated the following studios: Paramount, Columbia, M.C.A., Fox, MGM, and Orion. *Id.* Among the reasons that Warner was considered to present the best opportunity were: (1) its successful movie studio; (2) the ease with which its cable operations would blend with that of Time's; (3) it had a "presence" in the music industry whereas Time did not; (4) its international distribution capabilities; and (5) the success that the corporation had attained under the direction of its current chief executive officer. *Id.*

It should also be noted that Time's chairman and chief executive officer (J. Richard Munro) and its president and chief operating officer (N.J. Nicholas, Jr.) held meetings with the outside directors to consider Time's long-term business plans before the July 1988 full board meeting. The directors, who were involved in such discussions, "endorsed" the idea of a consolidation between the two corporations. *Id.*, slip op. at 6, 12-13, *reprinted in* 15 DEL. J. CORP. L. at 709, 713.

59. *Id.*, slip op. at 14, *reprinted in* 15 DEL. J. CORP. L. at 713.

60. *Id.*, slip op. at 14, *reprinted in* 15 DEL. J. CORP. L. at 714. Three of the four directors considered it important that Time's senior management retain their positions of control if a combined enterprise was to result. *Id.*, slip op. at 15, *reprinted in* 15 DEL. J. CORP. L. at 714. *See supra* notes 54-55 and accompanying text (explaining reasoning behind this concern).

61. *Id.*, slip op. at 18, *reprinted in* 15 DEL. J. CORP. L. at 716.

62. *Id.*

63. *Id.* Warner required this type of transaction because of the tax and accounting advantages (i.e., pooling of interest) that it may offer. *Id.*

ceed with the merger negotiations, as long as the conditions regarding control of the combined company were satisfied.[64]

Some difficulty was initially experienced by the two corporations in reaching an agreement regarding a management structure that would satisfy Time's control requirement;[65] the plan to have a sole Time officer succeed to the position of chief executive officer of the combined entity was the primary obstacle.[66] However, the two companies reached an agreement providing for the incumbent Warner chief executive officer to retire five years after the merger, with Time's incumbent president and chief operating officer succeeding as the sole chief executive officer of Time-Warner.[67]

The remaining terms of the merger did not meet with any resistance.[68] There was agreement as to the twenty-four split-member board, the Time editors' reporting relationship to an editorial board committee,[69] and the exchange ratio in the stock-for-stock transaction. The exchange ratio would be .465 of a Time share for each share of Warner stock,[70] a ratio that was approximately a 12% premium for the shareholders of Warner.[71] The members of each board gave approval to enter into the merger agreement on March 3, 1989,[72] and the agreement was entered into on the same date.[73]

An additional aspect of the merger agreement provided for Warner to be merged into a wholly-owned subsidiary of Time, with Warner ultimately remaining as the "surviving" company.[74] Following this transaction, Warner's common stock would then convert

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64. *Id.*, slip op. at 18-19, *reprinted in* 15 DEL. J. CORP. L. at 716.

65. *Id.*, slip op. at 19, *reprinted in* 15 DEL. J. CORP. L. at 716.

66. *Id.*, slip op. at 19-20, *reprinted in* 15 DEL. J. CORP. L. at 717. Apparently, Warner's incumbent chief executive offer did not find the notion of setting a retirement date an "appealing" proposition. *Id.*, slip op. at 20, *reprinted in* 15 DEL. J. CORP. L. at 717.

67. *Id.*, slip op. at 20, *reprinted in* 15 DEL. J. CORP. L. at 717.

68. *Id.*

69. *Id.*, slip op. at 19, *reprinted in* 15 DEL. J. CORP. L. at 716-17.

70. *Id.*, slip op. at 21, *reprinted in* 15 DEL. J. CORP. L. at 717.

71. *Id.* In setting the terms of the exchange ratio, some of the members of Time's Board determined that Time should be considered the acquiror and, therefore, a premium should be paid to the Warner shareholders. *Id.*, slip op. at 20, *reprinted in* 15 DEL. J. CORP. L. at 717.

72. *Id.*, slip op. at 21, *reprinted in* 15 DEL. J. CORP. L. at 718.

73. *Id.* The chancery court noted that this transaction was authorized by a majority of each corporation's outside directors, who received the appropriate advice. Furthermore, it appeared to be "an arm's-length negotiated agreement between two parties seeking individual advantage through mutual action." *Id.*

74. *Id.*, slip op. at 21-22, *reprinted in* 15 DEL. J. CORP. L. at 718.

into Time common stock at a specified ratio.[75] The General Corporation Law of Delaware required that the holders of a majority of the Warner shares approve the merger; the Time shareholders' approval was not needed because their stock would not be affected by the transaction.[76] However, the New York Stock Exchange rules required approval by both the Time and Warner shareholders.[77] Accordingly, the Time Board determined that the merger would be proposed to the shareholders at the next annual shareholders meeting, which was scheduled for June 23, 1989.[78]

At the March 3, 1989 meetings, the Time and Warner Boards also approved a "Share Exchange Agreement,"[79] under which each corporation had the option to exchange a certain number of shares of stock for shares of the other corporation's stock, presumably to protect the transaction from uninvited interference.[80] In addition, since each corporation's management was concerned that the merger agreement would be considered as putting the two entities "in play,"[81] agreements were obtained from banks in which they promised not to finance a takeover of Time.[82] The merger agreement had a provision that Time could not enter into any takeover arrangement

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75. *Id.*, slip op. at 22, *reprinted in* 15 DEL. J. CORP. L. at 718.

76. *Id.* (citing DEL. CODE ANN. tit. 8, § 251 (Supp. 1988)).

77. *Id.* Due to the number of Time shares to be issued, a shareholder vote was required in order to effectuate the transaction. *Id.*

78. *Id.*, slip op. at 25, *reprinted in* 15 DEL. J. CORP. L. at 720.

79. *Id.*, slip op. at 22, *reprinted in* 15 DEL. J. CORP. L. at 718.

80. *Id.*, slip op. at 22-23, *reprinted in* 15 DEL. J. CORP. L. at 718-19. Under the share exchange agreement, Warner was entitled to receive 7,080,016 shares of Time (11.1%), and Time was entitled to receive 17,292,747 shares of Warner (9.4%). *Id.* One reason for executing this agreement was that each party would have "an investment in the other" if the merger was not completed. *Id.*, slip op. at 23, *reprinted in* 15 DEL. J. CORP. L. at 718. The chancery court also assumed that "its principal purpose was to discourage any effort to upset the transaction." *Id.*, slip op. at 23, *reprinted in* 17 DEL. J. CORP. L. at 719 (citations omitted).

The share exchange agreement approved in this case is commonly known as a "lock up." Generally, a lock-up is:

> an option given to a favored bidder to purchase important target assets or authorized target stock at an advantageous price. A lock-up option is generally exercisable if the merger fails to close due to shareholder rejection or, more commonly, if a competing bidder acquires a certain percentage of target shares.

Johnson & Siegel, *Corporate Mergers: Redefining the Role of Target Directors*, 136 U. PA. L. REV. 315, 354 n.131 (1987).

81. *Id.*, slip op. at 24, *reprinted in* 15 DEL. J. CORP. L. at 719.

82. *Id.* This type of bank agreement is commonly referred to as a "dry-up" agreement. *See id.*

before the completed transaction, unless the offeror purchased 10% of its stock or unless the offer was for at least 25% of its outstanding stock.[83] However, if either of those events transpired, Time was required to obtain Warner's approval before communicating with the acquiror.[84]

On June 7, 1989, Paramount extended an all-cash, all-shares tender offer of $175 per share to Time's stockholders,[85] subject to the following restrictions:

> 1. termination of the Time-Warner merger agreement (or the agreement being left subject to a vote in which Paramount controlled 51% of the vote);
> 2. termination or invalidation of the Share Exchange Agreement under circumstances in which there would be no liability to Time;
> 3. Paramount to be satisfied in its sole discretion that all material approvals, consents and franchise transfers relating to Time's programming and cable television business had been obtained on terms satisfactory to Paramount;
> 4. removal of a number of Time-created or Time-controlled impediments to closing of the offer (*e.g.*, redemption of a "poison pill" preferred rights purchase plan) or effectuation of a second-stage merger (*e.g.*, supermajority voting requirements of 8 Del. C. § 203 and supermajority voting provisions of Time's certificate of incorporation) and;
> 5. financing and majority acceptance of the offer.[86]

Time's management reacted to the Paramount offer by forwarding a letter to Paramount which clearly stated that Time was

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83. *Id.*, slip op. at 24-25, *reprinted in* 15 DEL. J. CORP. L. at 719. "'Time may not solicit or encourage or take any other action to facilitate any inquiries on the making of any proposal which constitutes or may . . . lead to, any takeover proposal.'" *Id.*, slip op. at 25, *reprinted in* 15 DEL. J. CORP. L. at 719 (quoting Ross Exh. 10, at 16-17). This type of merger provision is known as a "no-shop" covenant. Generally, this type of covenant "prohibit[s] the target from actively seeking competing bids. Usually included within no-shop covenants are 'no negotiation' provisions, which prohibit the target from negotiating with potential competing bidders or from furnishing any nonpublic information to any third party seeking to acquire the target." Johnson & Siegel, *supra* note 80, at 353 n.130.

84. *Id.*, slip op. at 25, *reprinted in* 15 DEL. J. CORP. L. at 719-20. Even if this scenario occurred, Time was still obligated to perform under the merger agreement. *Id.*, slip op. at 25, *reprinted in* 15 DEL. J. CORP. L. at 720.

85. *Id.*

86. *Id.*, slip op. at 26, *reprinted in* 15 DEL. J. CORP. L. at 720.

not on the auction block and that it fully intended to effectuate the merger with Warner.[87] In addition, Time's Board convened on four separate occasions to consider the Paramount tender offer, and on June 16, 1989, resolved to reject it.[88] At the same time, the board also resolved to alter the structure of the original merger agreement with Warner to avoid a Time shareholder vote.[89]

The Time Board determined that the $175 offer was inadequate in the event that Time was to be sold.[90] The board was informed that if the company were to be sold, "'the price would likely be greater than $250 per share . . . .'"[91] Investment bankers provided the board with price valuation ranges in other change-of-control situations, all of which also exceeded the $175 per share offer.[92] Furthermore, the board was informed that the stock of Time-Warner would trade at about $150 per share, and the projected trading range would be between $106-$188 per share in 1990, and between $159-$247 in 1991.[93]

The board also reviewed the conditions that Paramount imposed on its offer with respect to acquiring the cable and programming franchise transfer approvals and concluded that those provided Paramount with "a free option on the company for some period necessary to see if the transfer of all material franchises could be arranged."[94]

It should be noted that the board did consider Paramount as a potential partner in advancing its corporate objectives, but concluded that the Warner transaction was still the best course to pursue as

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87. *Id.*, slip op. at 27-28, *reprinted in* 15 DEL. J. CORP. L. at 721.

88. *Id.*, slip op. at 28, *reprinted in* 15 DEL. J. CORP. L. at 721-22.

89. *Id.*, slip op. at 28-29, *reprinted in* 15 DEL. J. CORP. L. at 722. *See infra* text accompanying notes 98-101 (discussing the terms of the revised Time-Warner merger agreement).

90. *Paramount*, No. 10,866, slip op. at 29-30, *reprinted in* 15 DEL. J. CORP. L. at 722.

91. *Id.*, slip op. at 30, *reprinted in* 15 DEL. J. CORP. L. at 722-23 (footnote omitted) (quoting Rossoff Aff., ¶ 30). This price valuation was based on a pre-tax segment value range and not on a "bust-up" acquiror. *Id.*, slip op. at 31, *reprinted in* 15 DEL. J. CORP. L. at 723.

92. *Id.*, slip op. at 31, *reprinted in* 15 DEL. J. CORP. L. at 723. For example, the board was advised of the valuation ranges for a "strategic" acquiror, a leveraged buyout, and a recapitalization. *Id.*

93. *Id.*, slip op. at 32-33, *reprinted in* 15 DEL. J. CORP. L. at 724. The trading ranges of $230-$332 and $208-$402 were projected for 1992 and 1993, respectively. *Id.*, slip op. at 33, *reprinted in* 15 DEL. J. CORP. L. at 724.

94. *Id.*, slip op. at 34, *reprinted in* 15 DEL. J. CORP. L. at 724. However, Time actively tried to prevent Paramount from obtaining the franchise approvals. *Id.*, slip op. at 33-34, *reprinted in* 15 DEL. J. CORP. L. at 724.

Paramount lacked a presence in the record industry.[95] More importantly, Paramount did not possess the "international distribution power of Warner."[96]

The board then decided to restructure the initial Warner merger transaction in response to the Paramount offer and its probable effect on the upcoming shareholder vote.[97] A cash acquisition transaction, which provided for Time to pay a $70 cash price for Warner shares, amounting to about a 56% premium for the Warner shareholders,[98] was approved by the board of Time.[99] In addition, the agreement between the two parties did not contain any conditions to Time's commitment to purchase the Warner shares, provided that the requisite number of shares was acquired.[100] In essence, there were three important differences between the "old" and "new" transaction: (1) Time would be saddled with a minimum of $7 million of additional debt, which would limit its capacity to obtain additional borrowing; (2) due to the amortization of about $9 billion of goodwill, the Time-Warner enterprise would not be expected to have any reported earnings; and (3) Warner would now realize a control premium of 56% versus the 12% contemplated by the original agreement.[101] This new transaction was approved by the board; at the same time, Warner triggered the Share Exchange Agreement.[102]

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95. *Id.*, slip op. at 34, *reprinted in* 15 DEL. J. CORP. L. at 725.

96. *Id.*

97. *Id.*, slip op. at 37, *reprinted in* 15 DEL. J. CORP. L. at 726. The following language was contained in Time's Schedule 14D-9 filing:

> In response to the serious threat posed by the PCI offer to Time's effectiveness in furthering such strategic objectives and corporate policies, including its ability to consummate the Original Merger, the Board of Directors determined to modify the terms of the Original Merger as described in Item 7 below.

Id., slip op. at 37, *reprinted in* 15 DEL. J. CORP. L. at 726-27.

98. *Id.*, slip op. at 38, *reprinted in* 15 DEL. J. CORP. L. at 727. The original merger agreement represented a 12% premium for the Warner stockholders. *See supra* text accompanying note 71.

99. *Id.*, slip op. at 40, *reprinted in* 15 DEL. J. CORP. L. at 728.

100. *Paramount*, No. 10,866, slip op. at 38-39, *reprinted in* 15 DEL. J. CORP. L. at 727.

101. *Id.*, slip op. at 39-40, *reprinted in* 15 DEL. J. CORP. L. at 727-28. The concept of dual chief executive officers and a board composed of incumbent directors from each corporation was still intact from the prior agreement. *See supra* text accompanying notes 61-62 & 67 (discussing the managerial structure of the merged entity).

102. *Paramount*, No. 10,866, slip op. at 40, *reprinted in* 15 DEL. J. CORP. L. at 728. *See supra* note 80 and accompanying text (describing the terms of the Share Exchange Agreement).

Paramount responded by increasing its offer to $200 per share on June 23, 1989, and at a board meeting held on June 26, 1989, the Time directors rejected that offer for the same reasons that they found the $175 per share offer inadequate.[103] Furthermore, the Paramount offer remained conditioned upon the termination of the Warner agreement, and the Time directors considered Time legally bound to complete that transaction.[104]

As a result of the Time Board's decision to reformat the merger transaction and to reject the tender offer, Paramount, and two groups of Time shareholders, filed actions seeking a preliminary injunction to enjoin Time from proceeding with its cash offer to purchase 51% of Warner's stock at $70 per share.[105] The defendants in the action were Time and its directors as well as Warner.[106]

B. The Delaware Chancery Court Decision

The chancery court first addressed the plaintiffs' contention that the directors of Time had a "supervening fiduciary obligation" to allow the shareholders to maximize their current share values by accepting the Paramount tender offer and, thus, were under an obligation not to complete the Warner tender offer that was designed to maximize future share values.[107] The court based its legal analysis on the premise that there is a distinction between maximizing current values and maximizing long-term share values[108] and stated that the directors of a Delaware corporation are not under an obligation to

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103. *Paramount*, No. 10,866, slip op. at 40, *reprinted in* 15 DEL. J. CORP. L. at 728.

104. *Id.*, slip op. at 41, *reprinted in* 15 DEL. J. CORP. L. at 728. The revised agreement did not contain a provision whereby Time could forego its offer if a potential acquiror conditioned a tender offer upon such abandonment. *Id.*

105. *Id.*, slip op. at 1-2, *reprinted in* 15 DEL. J. CORP. L. at 706-07.

106. *Id.*, slip op. at 2, *reprinted in* 15 DEL. J. CORP. L. at 707. Three of the four directors who had recently resigned from the Time Board were named as defendants to the action. *Id.* It should be noted that the resignations of three of the board members were not due to disagreement over the Time-Warner transaction. *Id.*, slip op. at 7 n.2, *reprinted in* 15 DEL. J. CORP. L. at 710 n.2. One director's resignation may have been based in part on personal reservations about becoming associated with a corporation primarily involved in the entertainment industry. However, this director did approve the Time-Warner transactions as being in the best interest of the corporation and its shareholders. *Id.*

107. *Id.*, slip op. at 2, *reprinted in* 15 DEL. J. CORP. L. at 707.

108. *Id.*, slip op. at 47, *reprinted in* 15 DEL. J. CORP. L. at 732.

"maximize the immediate value of the corporation or its shares," unless the *Revlon* auction rule is triggered.[109]

The court then analyzed whether the original merger transaction represented a change in control and, therefore, triggered a duty on the part of Time's directors to maximize the corporation's immediate share values. While acknowledging that it is not necessary for the board to explicitly decide to sell the corporation before the *Revlon* duties are imposed, the court held that the initial merger agreement did not amount to a transfer of control.[110] Hence, the original merger transaction did not come under the auspices of the *Revlon* auction rule.

In reaching this conclusion, the court turned to the specific facts underlying the transaction.[111] The court reasoned that prior to the completion of the stock-for-stock transaction, the stock of each corporation was largely held in the market and, upon the completion of the proposed transaction, the actual control of each corporation would continue to remain in the market.[112] Accordingly, the court considered it irrelevant that, at the close of the original transaction, the former Warner shareholders would hold 62% of the combined entity's stock.[113]

The court then addressed the shareholder-plaintiffs' argument that the *Revlon* auction rule applies when a board decides to approve a transaction which precludes a future change in control.[114] This argument implies that the directors were under a duty to maximize current share values by selling Time because the initial merger agreement prevented the shareholders from realizing a control premium in the future.[115] Although the court noted that the merger

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109. *Id.*, slip op. at 50 (citing Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1988); Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334 (Del. 1987); Revlon v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986)), *reprinted in* 15 DEL. J. CORP. L. at 734. *See supra* notes 32-41 and accompanying text (discussing the *Revlon* rule).

110. *Paramount*, No. 10,866, slip op. at 58-59 (citing *Macmillan*, 559 A.2d at 1345), *reprinted in* 15 DEL. J. CORP. L. at 738-39.

111. *Id.*, slip op. at 59, *reprinted in* 15 DEL. J. CORP. L. at 739.

112. *Id.*, slip op. at 59-60, *reprinted in* 15 DEL. J. CORP. L. at 739.

113. *Id.*, slip op. at 59, *reprinted in* 15 DEL. J. CORP. L. at 739. Based upon a .465 exchange ratio, the Warner shareholders would own about 62% of the stock of Time-Warner. This figure, however, may be deceiving. The supreme court noted that this number did not take into account the individuals who owned shares in both corporations. *Paramount*, 571 A.2d at 1146 n.7.

114. *Paramount*, No. 10,866, slip op. at 60, *reprinted in* 15 DEL. J. CORP. L. at 740.

115. *Id.*

agreement did not legally foreclose a future sale of the corporation, it did concede that a change of control transaction would now become very unlikely as a practical matter.[116] Nonetheless, the court dismissed this argument on two grounds.

First, the court stated that neither a potential acquiror nor a target's shareholders possess the right to prevent the directors from actively managing the company while a takeover attempt is in progress.[117] Furthermore, the court noted that, as long as the board acts in good faith and in an informed fashion, its decisions will be protected.[118] Second, the court stated that if the board's activities are considered defensive in nature, they must also be deemed reasonable in relation to the threat presented.[119] The court concluded by stating that "the validity of 'defensive' measures is addressed under a *Unocal* analysis, not under the narrower *Revlon* case."[120]

The court then turned to the shareholder-plaintiffs' argument that the board was under a duty to allow the shareholders to choose whether or not to accept Paramount's tender offer and that, by avoiding a shareholder vote, the shareholders were disenfranchised.[121] The court began its analysis by stating that it is a "well established [principle] in Delaware law that manipulation of the corporate machinery for the accomplishment of inequitable purposes will not be countenanced."[122] The court then drew a distinction between the case of *Blasius v. Atlas Corp.*[123] and the facts of the instant case to

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116. *Id.*, slip op. at 61, *reprinted in* 15 DEL. J. CORP. L. at 740.

117. *Id.* The chancery court stated that "a would-be acquiror (or the target company's shareholders) has no right to stay the exercise of director power under Section 141 pending the resolution of an attempt to acquire control." *Id.*

118. *Id.*

119. *Id.* (quoting UIS, Inc. v. Walbro Corp., No. 9323 (Del. Ch. Oct. 6, 1987), *reprinted in* 13 DEL. J. CORP. L. 806 (1988)). *See also Interco*, 551 A.2d at 801 (decision to sell corporate division was reasonable in response to a pending noncoercive tender offer).

120. *Paramount*, No. 10,866, slip op. at 63, *reprinted in* 15 DEL. J. CORP. L. at 741-42. *See supra* text and accompanying notes 23-31 (discussing the *Unocal* standard of review).

121. *Paramount*, No. 10,866, slip op. at 64, *reprinted in* 15 DEL. J. CORP. L. at 742.

122. *Id.* (citing Schnell v. Chris-Craft Indus., 285 A.2d 437 (Del. 1971); Blasius v. Atlas Corp., No. 9720 (Del. Ch. July 25, 1988); Aprahamian v. HBO & Co., 531 A.2d 1204 (Del. Ch. 1987); Canada S. Oils, Ltd. v. Manabi Exploration Co., 96 A.2d 810 (Del. Ch. 1953)).

123. No. 9720 (Del. Ch. July 25, 1988).

conclude that the shareholder-plaintiffs did not possess a right to vote on the initial merger with Warner.[124]

In *Blasius*, the incumbent directors used their power to preclude an election of the corporation's directors by a shareholder consent vote.[125] The court in that case found that the board action was not protected by the business judgment rule, although it was made in good faith.[126] The board had the burden of showing a "compelling justification" for its action which disenfranchised the shareholders.[127]

In rejecting the franchise theory, the chancellor found that, unlike the plaintiffs in *Blasius*, the Time shareholders were not exercising rights conferred to them by statute.[128] The court reasoned that, while the original merger transaction necessitated board approval, it did not necessitate a shareholder vote under Delaware law.[129] Furthermore, the court found no support for the proposition that once a board decides to approve a merger, it is foreclosed from revoking that approval and then eliminating a planned shareholder vote.[130]

The court next considered whether to review the board's decision to approve the Warner tender offer under the enhanced scrutiny applied to defensive actions. The court rejected the defendants' contention that since the board simply approved a revision to a preexisting transaction after the Paramount offer emerged, its decision

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124. *Paramount*, No. 10,866, slip op. at 66-67, *reprinted in* 15 DEL. J. CORP. L. at 743.

125. *Id.*, slip op. at 66, *reprinted in* 15 DEL. J. CORP. L. at 742. *See generally* Note, *Written Consents—A Powerful Tool in Hostile Battles for Corporate Control*, 14 DEL. J. CORP. L. 967 (1989) (discussing Delaware's written consent statute and relevant case law).

126. *Blasius*, No. 9720, slip op. at 33.

127. *Id. See Paramount*, No. 10,866, slip op. at 66, *reprinted in* 15 DEL. J. CORP. L. at 743.

128. *Paramount*, No. 10,866, slip op. at 66-67, *reprinted in* 15 DEL. J. CORP. L. at 743. The court considered American Int'l Rent A Car, Inc. v. Cross, No. 7583 (Del. Ch. May 9, 1984) (denying a preliminary injunction where the board amended the corporate bylaws to prevent a shareholder vote), *reprinted in* 9 DEL. J. CORP. L. 144 (1984), to be more analogous to the present case. *Paramount*, No. 10,866, slip op. at 67, *reprinted in* 15 DEL. J. CORP. L. at 744.

129. *Paramount*, No. 10,866, slip op. at 66, *reprinted in* 15 DEL. J. CORP. L. at 743. The scheduled shareholder vote was required under New York Stock Exchange rules. *Id.*, slip op. at 66 n.18, *reprinted in* 15 DEL. J. CORP. L. at 743 n.18.

130. *Id.*, slip op. at 66-67, *reprinted in* 15 DEL. J. CORP. L. at 743. The court also noted that the board action taken to avoid a shareholder vote did not violate the corporation's charter. *Id.*, slip op. at 67, *reprinted in* 15 DEL. J. CORP. L. at 744.

should not be reviewed under an enhanced form of the business judgment rule.[131] According to the court, enhanced judicial review or *Unocal* applies "to all actions taken after a hostile takeover attempt has emerged that are found to be defensive in character."[132] The court supported its decision to apply *Unocal* by noting that Time itself stated that the tender offer was in response to the threat that the Paramount offer presented to the Warner transaction.[133]

Once the court concluded that the revised transaction must withstand a *Unocal* analysis, it had to determine whether there were "reasonable grounds for believing that a danger to corporate policy and effectiveness existed . . . ."[134] Specifically, the court addressed the issue of whether the Paramount tender offer posed a threat to a corporate policy that required protection.[135] The court reasoned that, since the board was not under a duty to maximize current share values and decided to proceed with an existing plan to maximize long-term share values, the corporation had an interest in ensuring that the plan was carried out.[136] Therefore, the court concluded, a danger did exist to corporate policy as a result of the Paramount offer.[137] The court's evaluation stressed that, although the revised transaction was defensive in character, its genesis was in a long-term business plan designed to achieve future profits.[138] Furthermore, the court was impressed by the fact that the purpose of the original merger was not to provide Time with a defense mechanism, but

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131. *Id.*, slip op. at 68-69, *reprinted in* 15 DEL. J. CORP. L. at 744-45.

132. *Id.*, slip op. at 69 (citations and footnotes omitted), *reprinted in* 15 DEL. J. CORP. L. at 745.

133. *Id.*, slip op. at 70, *reprinted in* 15 DEL. J. CORP. L. at 746. The court supports its finding by referring to Time's Schedule 14D-9 filing. *Id. See supra* note 97 (quoting the language contained in Time's filing).

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

135. *Paramount*, No. 10,866, slip op. at 70, *reprinted in* 15 DEL. J. CORP. L. at 746.

136. *Id.*, slip op. at 75, *reprinted in* 15 DEL. J. CORP. L. at 748.

137. *Id.*

138. *Id.*, slip op. at 74, *reprinted in* 15 DEL. J. CORP. L. at 748. Specifically, the chancellor stated:

> I conclude that the achievement of the long-term strategic plan of the Time-Warner consolidation is plainly a most important corporate policy; while the transaction effectuating that policy is reactive in important respects (and thus must withstand a *Unocal* analysis), the policy itself has, in a most concrete way, its origin in non-defensive, *bona fide* business considerations.

Id.

rather was for the specific purpose of achieving the corporation's long-term goals.[139]

In determining that the Paramount offer posed a threat to an interest that justified defensive action, the court distinguished the instant case from two prior decisions, *City Capital Associates Ltd. v. Interco Inc.*[140] and *Grand Metropolitan Public Ltd. v. Pillsbury Co.*,[141] where both courts found that the threat posed did not justify the defensive steps taken.

In *Interco*, the board of directors sought to defeat a noncoercive all-cash, all-shares tender offer and back-end merger for the same consideration by not redeeming a "poison pill" rights plan.[142] In addition, the board proposed the implementation of an alternative restructuring transaction which included a sale of assets, an increase in debt, and a large dividend payment.[143] The tender offer was for $74, while the restructuring was valued at $76.[144]

The court, in that case, found that the poison pill's principal purpose was to protect the implementation of the restructuring.[145] The court also found that the only threat the tender offer posed was to the shareholders' economic interests, and the only function the "poison pill" served was to "deprive shareholders of the ability effectively to choose to accept a noncoercive offer . . . ."[146] The court held that the threat posed was not sufficient to justify leaving the rights plan in place.[147]

Similarly, in *Pillsbury*, the board did not redeem a poison pill rights plan when confronted with an all-cash, all-shares tender offer.[148] As a further response to the tender offer, the board proposed a plan to sell a substantial amount of the corporation's assets over a five-year period to provide enhanced long-term value to its shareholders.[149] The court found that the only threat presented by the tender offer

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139. *Id.*

140. 551 A.2d 787 (Del. Ch. 1988).

141. 558 A.2d 1049 (Del. Ch. 1988).

142. *Interco*, 551 A.2d at 789-90. *See generally* 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) (discussing duty of Delaware directors to redeem poison pills).

143. *Interco*, 551 A.2d at 793.

144. *Id.* at 790.

145. *Id.*

146. *Id.* at 799.

147. *Id.* at 798.

148. *Pillsbury*, 558 A.2d at 1052.

149. *Id.* at 1057.

was to shareholder value and not to the "corporate entity,"[150] and that the poison pill's only purpose was to foreclose the shareholders from accepting the tender offer.[151] Therefore, the court held that the board's action was "not reasonable in relation to any threat posed."[152]

The court in *Paramount* distinguished the *Interco* and *Pillsbury* cases on several factual grounds. First, in each case, not only was management trying to force a proposed alternative transaction on its shareholders, but also this alternative was the "functional equivalent of the very leveraged 'bust up' transaction that management was claiming presented a threat to the corporation."[153] In both cases, the primary purpose of the proposed transaction was to ensure management retained corporate control.[154] The court placed great importance on the fact that although the revised Time-Warner agreement was defensive in character, this was not the agreement's primary purpose.[155]

Another distinction the court drew was that the revised merger agreement and the Paramount tender offer were not necessarily alternative transactions, but appeared that way because of the manner in which Paramount structured its offer.[156]

The court considered *Shamrock Holdings, Inc. v. Polaroid Corp.*[157] to be more on point than either *Interco* or *Pillsbury*. In *Shamrock*, the chancery court upheld the validity of an enlarged Employee Stock Ownership Plan (ESOP) adopted partially as an antitakeover device to a hostile suitor.[158] While the court acknowledged the ESOP's impact as a defensive measure to thwart an existing takeover attempt, it upheld the plan based on an entire fairness evaluation.[159] The

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150. *Id.* at 1058.

151. *Id.* at 1060.

152. *Id.*

153. *Paramount*, No. 10,866, slip op. at 72-73, *reprinted in* 15 DEL. J. CORP. L. at 747.

154. *Paramount*, No. 10,866, slip op. at 73, *reprinted in* 15 DEL. J. CORP. L. at 747.

155. *Id.*

156. *Id.*, slip op. at 74-75, *reprinted in* 15 DEL. J. CORP. L. at 748. Paramount conditioned its tender offer on the termination of the Time-Warner merger agreement. *See supra* text accompanying notes 85-86 (quoting the terms of the Paramount offer).

157. 559 A.2d 257 (Del. Ch. 1989).

158. *Id.* at 276.

159. *Id.* at 275. An entire fairness evaluation is a rigorous test and is applied where an individual stands on both sides of a transaction, such as in a parent-subsidiary situation. Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).

ESOP survived this strict scrutiny for the following reasons: (1) it had been considered prior to the takeover attempt; (2) it was designed to enhance long-term share values; and (3) its sole purpose was not to retain corporate control.[160] The court in the instant case was impressed that the Time-Warner merger was planned prior to the emergence of the Paramount offer and designed to achieve the corporation's long-term profit goals, and was not primarily a corporate control defense mechanism.[161] Therefore, the court considered the merger a "most important corporate policy,"[162] and concluded that the Time directors did have an interest to protect in achieving this corporate policy.[163]

Having dealt with the first prong of *Unocal*, the court turned to the question of whether the directors' response bore a reasonable relationship to the threat posed by the Paramount tender offer. The court acknowledged that this stage of the *Unocal* analysis requires various factors to be evaluated, such as the significance of the corporate objective, the availability of other means to protect the threatened objective, and the effect of the defensive measure.[164] Before evaluating the reasonableness of Time's response, the court noted that *Unocal* should be applied in a conservative fashion in order to protect the benefits of the business judgment rule.[165]

In addressing this second prong of the analysis, the court stated that the objective of realizing the corporation's strategic business plan was "reasonably seen as of unquestionably great importance

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This test of entire fairness has two parts: fair dealing and fair price. *Id.* at 711. The supreme court has described the test as follows:

> The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of the company's stock.

Id. (citations omitted). *See also* Sterling v. Mayflower Hotel Corp., 93 A.2d 107 (Del. 1952) (entire fairness evaluation applied to a parent-subsidiary merger).

160. *Shamrock Holdings*, 559 A.2d at 275-76.

161. *Paramount*, No. 10,866, slip op. at 74, *reprinted in* 15 DEL. J. CORP. L. at 748.

162. *Id.*

163. *Paramount*, No. 10,866, slip op. at 75, *reprinted in* 15 DEL. J. CORP. L. at 748.

164. *Id. See* Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

165. *Paramount*, No. 10,866, slip op. at 75, *reprinted in* 15 DEL. J. CORP. L. at 748.

by the board."[166] This statement by the court set the stage for the remainder of its *Unocal* evaluation. The court found that the board's approval of the revised merger transaction, in order to protect this important objective, was "effective but not overly broad."[167] The court pointed out that, in approving the revised transaction, the board took only the necessary steps to preserve the original transaction.[168] Furthermore, the court found that this defensive measure did not legally foreclose a successful effectuation of a hostile tender offer.[169] While acknowledging that, as a practical matter, the revised transaction may significantly deter a takeover attempt of the consolidated entities, the court concluded that such an attempt was not shown to have been permanently precluded.[170] Based on these factors, the court held that the revised Time-Warner merger agreement, as well as the Warner tender offer, were reasonable responses to the threat that the Paramount offer posed to the planned merger.[171]

After concluding that the mandate of *Unocal* had been satisfied, the court stated that there was "no persuasive evidence" that the board had improper motives in deciding to pursue the corporation's long-term corporate objectives by approving the Warner tender offer; the directors were acting within their powers to manage the affairs of the corporation.[172] The court noted that, due to the timing of the transaction, the board did not have to depend upon its power to veto a shareholder vote in order to retain corporate control.[173] The court suggests that if the primary purpose of the transaction was to provide a control mechanism, different factors may have been considered in its *Unocal* analysis.[174] The fact that the board's decision to approve the merger transaction was viewed as one with an "independent business purpose," lends support to the court's conclusion

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166. *Id.*, slip op. at 76, *reprinted in* 15 DEL. J. CORP. L. at 749.
167. *Id.*
168. *Id.*
169. *Id.*
170. *Id.*
171. *Id.*
172. *Id.*, slip op. at 76-77, *reprinted in* 15 DEL. J. CORP. L. at 749.
173. *Id.*, slip op. at 77, *reprinted in* 15 DEL. J. CORP. L. at 749.
174. *Id.*, slip op. at 77 n.22, *reprinted in* 15 DEL. J. CORP. L. at 749 n.22. The chancellor is referring to a decision by a board of directors not to redeem a poison pill. *See, e.g.*, Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); City Capital Assocs. Ltd. v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988).

that the board did not breach its duty to the shareholders.[175] The court also pointed out that it is the duty of the directors to manage the affairs of the corporation and, in performing its duty, the board is not required to act according to the "wishes of a majority of shares."[176] Finally, the court stated that although the board's decision may eventually prove to be erroneous, and the majority of the shareholders may not be in agreement with the decision, the circumstances presented did not establish grounds for declining the board the protection of the business judgment rule.[177] As a result, the chancery court denied the plaintiff's motion for a preliminary injunction.

C. *The Delaware Supreme Court Decision*

On interlocutory appeal, the Delaware Supreme Court affirmed the chancery court's denial of a preliminary injunction.[178] However, the supreme court's decision on the *Revlon* issue was based upon broader grounds than the lower court's decision.[179] In addition, the supreme court clarified the appropriate standard of review under *Unocal*.[180]

The court began its legal analysis by stating the critical issue presented as: "Did Time, by entering into the proposed merger with Warner, put itself up for sale?"[181] Accordingly, the court first addressed the shareholder-plaintiffs' argument that, by entering into the original merger transaction with Warner, *Revlon* duties were imposed upon the Time directors.[182] The court found that the chancellor was correct as a matter of law in concluding that, as there was no change in control, the *Revlon* duties were not triggered by the original merger agreement.[183] Unlike the chancery court, however, the supreme court based its finding on broader grounds. The court reasoned that, since the negotiations between Time and Warner did

175. *Paramount*, No. 10,866, slip op. at 77 n.22, *reprinted in* 15 DEL. J. CORP. L. at 749 n.22.

176. *Id.*, slip op. at 77, *reprinted in* 15 DEL. J. CORP. L. at 749-50.

177. *Id.*, slip op. at 78, *reprinted in* 15 DEL. J. CORP. L. at 750.

178. *Paramount*, 571 A.2d at 1142.

179. *Id.* at 1150.

180. *Id.* at 1153.

181. *Id.* at 1150.

182. *Id.*

183. *Id. See supra* text accompanying notes 110-13 (discussing the chancellor's *Revlon* analysis).

not make the dissolution or break-up of the corporation inevitable, there was no legal basis for applying the *Revlon* rule.[184]

The court went further in addressing this argument by specifying the two primary situations that will trigger the *Revlon* duties. First, *Revlon* will apply when the corporation either initiates an auction with the anticipation of a sale or effectuates a reorganization that will break up the entity.[185] Second, an auction of the corporation to maximize immediate share values will be required where a corporation responds to a hostile attempt by foregoing its long-term plans and pursuing a transaction that will break up the corporation.[186]

In addition, the court explicitly affirmed the chancellor's determination that a *Revlon* analysis is not appropriate where a target corporation's response to a hostile offer is purely defensive *and* the continued existence of the corporation is contemplated.[187] In this situation, the enhanced standard of review mandated by *Unocal* is applicable.[188]

The court next addressed the plaintiffs' argument that the original merger agreement made the sale of Time inevitable because certain Time directors were concerned that the transaction may be perceived as putting Time "up for sale."[189] The court again agreed with the chancellor's conclusion that such concerns on the part of certain directors did not invoke the *Revlon* duties. The court stated two reasons for this conclusion: (1) there was insufficient evidence to impose *Revlon*; and (2) the *Revlon* rule does not extend to a transaction merely because it may be perceived as one that puts the corporation "in play" or "up for sale."[190]

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184. *Paramount*, 571 A.2d at 1150.

185. *Id. See, e.g.*, Mills Acquisition Co. v. Macmillan, Inc. 559 A.2d 1261 (Del. 1988)). *See infra* note 265 (discussing the first situation that will trigger *Revlon*).

186. *Paramount*, 571 A.2d at 1150. *See infra* note 266 (discussing the second situation that will trigger *Revlon*).

187. *Paramount*, 571 A.2d at 1150.

188. *Id.* at 1150-51. *See, e.g.*, *Ivanhoe Partners*, 535 A.2d at 1345. In *Ivanhoe Partners*, the court did not apply *Revlon* for two reasons: (1) the sale of Newmont was not clearly "inevitable," as the target resolved to remain an independent concern and accomplished this objective by employing defensive measures; and (2) there was no active auction or sale to a third party. *Id. See also supra* text accompanying notes 23-29 (discussing the *Unocal* standard of review).

189. *Paramount*, 571 A.2d at 1151.

190. *Id.* With respect to whether a corporation is "for sale" in the legal sense, the supreme court in Mills Acquisition Co. v. Macmillan, Inc. 559 A.2d 1261 (Del. 1988), stated:

Clearly not every offer or transaction affecting the corporate structure

The court also dismissed the plaintiffs' related contention that the various "structural safety devices,"[191] adopted by Time to protect the initial merger agreement, triggered *Revlon* because these devices foreclosed the shareholders from realizing a control premium in the near future.[192] In agreement with the chancellor, the court stated that the adoption of such devices, without more, does not invoke the *Revlon* duties; the validity of such devices are to be reviewed under a *Unocal* analysis.[193]

Turning to the restructuring of the initial stock-for-stock exchange agreement, the court concluded that such action did not result in either the inevitable sale of Time or a desertion of Time's corporate strategy and, therefore, *Revlon* was not invoked.[194] In support of this conclusion, the court noted that, while the board was given an opportunity to adopt alternatives to Paramount's offer, the board remained steadfast in its decision to pursue its preexisting plan.[195] The court further noted that, as the chancellor had concluded, a future acquisition or change in control of the combined entity may be large, but it is not impossible.[196] Therefore, realization of a future control premium by Time's shareholders was not legally foreclosed.

> invokes the *Revlon* duties. A refusal to entertain offers may comport with a valid exercise of business judgment. 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. at 1285 n.35 (citations omitted).

191. *Paramount*, 571 A.2d at 1151. To protect the initial merger agreement, Time and Warner entered into a share exchange agreement (the "lock-up" agreement); agreements were obtained from banks in which they promised not to finance a takeover of Time (the "dry-up" agreements); and Time agreed, at Warner's request, not to communicate with a potential acquiror until obtaining Warner's approval (the "no-shop" clause). *See supra* text and accompanying notes 80, 82-83 (describing these protective devices).

192. *Paramount*, 571 A.2d at 1151.

193. *Id. See also id.* at 1151 n.15 (discussing the chancellor's conclusions regarding the legality of each protective device used to safeguard the initial Time-Warner agreement).

194. *Id.* at 1151.

195. *Id.* at 1151 n.16. The court stated that "although Time's advisors presented the board with such alternatives as an auction or sale to a third party bidder, the board rejected those responses, preferring to go forward with its pre-existing plan rather than adopt an alternative to Paramount's proposal." *Id.*

196. *Id.* at 1151 (citing *In re* Time Inc. Shareholders Litig., No. 10,670, slip op. at 5, 6 (Del. Ch. July 14, 1989) (Allen, C.)).

Again, the court concluded that the validity of the revised transaction is to be reviewed under *Unocal*.[197]

The court then addressed the issue of whether the original Time-Warner stock-for-stock transaction was entitled to the presumption of the business judgment rule. Before concluding that the board's decision to effectuate the initial transaction was the result of a proper exercise of business judgment, the court noted that it "purposely detailed the evidence of the Time board's deliberate approach, beginning in 1983-[19]84, to expand itself."[198] In reaching its conclusion, the court was impressed by the following facts: (1) Time's calculated decision in the mid-1980s that it was critical to the company's future success to expand into the entertainment industry and international markets; (2) the insistence of Time's executives and directors to maintain Time's unique culture by preserving its journalistic integrity; and (3) the extensive search that Time undertook in order to find the most compatible partner to meet its strategic plans, prior to deciding upon Warner.[199] All of these actions preceded the initial merger agreement, as well as the Paramount tender offer, and provided the basis for the court's conclusion that the decision to enter into the initial agreement was an informed one entitled to the protection of the business judgment rule.

The court then discussed the revised Time-Warner transaction initiated by the board after the Paramount offer surfaced. The chancellor found that the revised transaction was a defensive maneuver designed to circumvent the negative impact that the Paramount tender offer would potentially have on the Time shareholder approval of the merger.[200] Consequently, the chancellor determined that *Unocal* was the proper standard to be applied to the board's decision to go forward with the Warner tender offer.[201] The court approved of the chancellor's ruling that any defensive actions taken by the Time

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197. *Id.*

198. *Id. See also id.* at 1143-49 (giving the supreme court's recitation of the facts giving rise to the controversy).

199. *Paramount*, 571 A.2d at 1152. *See also supra* text accompanying notes 48-60 (describing Time's decision to expand and its concerns about corporate culture and control).

200. *Paramount*, 571 A.2d at 1152. The supreme court noted that, while Paramount had made the decision to acquire Time in March of 1989, it deliberately postponed the public announcement of its offer until the proxy statements, containing the information on the Time-Warner proposal, were mailed to Time's shareholders. *Id.* at 1147 n.8.

201. *Id.* at 1152.

directors following the hostile tender offer were properly subject to a *Unocal* analysis.[202]

Before applying *Unocal* to the facts of the case, the court defined the fiduciary duties of a board of directors under *Unocal*. First, the court stated that before the business judgment rule will be applied to a defensive measure, the board has the burden of proving that: (1) there were "reasonable grounds for believing that a threat to corporate policy and effectiveness existed"; and (2) the defensive action was "reasonable in relation to the threat posed."[203] In order to satisfy the first prong of *Unocal*, the directors are required to demonstrate "good faith and reasonable investigation."[204] The court also noted that refusing to consider an offer indeed may be a "valid exercise of business judgment."[205]

The court then proceeded to discuss whether a defensive measure in response to an all-cash, all-shares tender offer, within an acceptable range of values, can satisfy the first part of *Unocal*. The court noted that certain chancery court decisions suggest that such offers cannot be considered a legitimate threat to corporate policy, as the only threat is to the shareholders and the value of their shares. Therefore, any defensive steps taken to thwart such offers, that are within an acceptable range of values that a shareholder may favor, cannot satisfy the two-prong test of *Unocal*.[206]

As a result of those lower court decisions, the plaintiffs argued that if Paramount's offer did constitute a threat, the only threat was inadequate share value. So, if it is determined that Paramount's all-cash, all-shares tender offer is within the range of values that the shareholders would consider superior to the management-sponsored transaction, the Paramount offer could not pose a legitimate threat to the shareholders or the corporation.[207] It would then follow that

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202. *Id. See* Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

203. *Paramount*, 571 A.2d at 1152 (citing Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985)).

204. *Id.*

205. *Id. See, e.g.*, *Macmillan*, 559 A.2d at 1285 n.35; *Smith*, 488 A.2d at 881; Pogostin v. Rice, 480 A.2d 619, 627 (Del. 1984).

206. *Paramount*, 571 A.2d at 1152 (citing Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); City Capital Assocs. Ltd. v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986)). *See also infra* text and accompanying notes 283-86 (discussing the chancery court decisions in *Interco* and *Pillsbury*).

207. *Paramount*, 571 A.2d at 1152.

the Time directors' defensive actions would violate the first prong of *Unocal*.

The court pointed out that Paramount's argument presupposed that hostile tender offers can constitute only two kinds of threats. First is the threat that two-tiered tender offers will force shareholders into tendering their shares in order to prevent unfair treatment during the second phase of the offer.[203] Second is the threat that the value of an all-cash, all-shares offer may be considered inadequate by the board when compared to what it believes in good faith to be the present value of the shares.[209]

The court forcefully rejected Paramount's "inadequate share value" argument and strongly cautioned the chancery court against such a strict application of *Unocal*.[210] The court reasoned that, if inadequate value is deemed to be the only consideration in deciding whether an all-cash, all-shares tender offer poses a threat to the corporation, it follows that the court must then decide what is the superior "deal" for the shareholders.[211] The effect of such a decision would be that the court would be substituting its own judgment for that of the board of directors.[212] The court adamantly stated that this type of *Unocal* approach is not at all proper.[213]

After rejecting this narrow approach, the court clarified the parameters of a proper *Unocal* analysis. The court stated that the value of *Unocal* was "precisely its flexibility in the face of a variety of fact scenarios."[214] The court listed the following factors that directors may consider in their evaluation of a takeover threat: "'the inadequacy of the price offered, nature and timing of the offer, questions of illegality, the impact on "constituencies" other than shareholders . . . the risk of nonconsummation, and the quality of securities being offered in the exchange.'"[215] The court opined that a proper analysis of these factors should not culminate in a "simple mathematical exercise"[216] whereby the court compares the discounted

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208. *Id.*

209. *Id.* at 1152-53 (Paramount's proposal would constitute this latter type of "threat.").

210. *Id.* at 1153.

211. *Id.*

212. *Id.*

213. *Id.*

214. *Id.*

215. *Id.* (quoting *Unocal*, 493 A.2d at 955). *See also supra* text accompanying notes 23-29 (discussing *Unocal*).

216. *Paramount*, 571 A.2d at 1153.

value of Time-Warner stock at a future date with the value of the Paramount offer, and then decides which is the superior value.[217] The court reasoned that a comparative analysis by the court, where it evaluates the "relative merits of a long-term versus short-term investment goal for shareholders," would violate the principles upon which the business judgment rule is predicated.[218] Moreover, such an analysis is not relevant as the directors are charged by statute with the task of determining what is in the best interests of shareholders "without regard to a fixed investment horizon."[219] Ultimately, this type of analysis would require a "distortion" in the application of the second leg of *Unocal*.[220]

Once the court clarified the scope of a proper *Unocal* analysis, it had to determine if the first leg of the test was satisfied. The court examined whether reasonable grounds existed for believing that the Paramount offer presented a threat to Time's corporate policy and effectiveness. The court found that the board had a reasonable basis for concluding that the Paramount offer posed more than just a threat of inadequate share value.[221] The board's conclusion was based on the following facts: (1) Time's shareholders may have tendered their shares without full knowledge of the potential benefits of the Warner transaction; (2) the conditions that Paramount imposed upon the offer created an "uncertainty" that may have slanted a comparative analysis; and (3) the timing of the Paramount offer was regarded as a means to disrupt and add confusion to the scheduled shareholder vote.[222] Based on this evidence, the court found that the board was justified in concluding that the Paramount offer was a threat to Time's corporate policy and effectiveness.[223] Moreover, the court found this evidence sufficient to support its finding that the board's decision was made in good faith, and not solely for purposes of entrenchment or self-interest.[224]

The court then responded to Paramount's allegation that the board did not properly investigate the uninvited tender offer and, therefore, the board's decision that the offer posed a threat was not

217. *Id.*
218. *Id.* at 1153.
219. *Id.* at 1150.
220. *Id.* at 1153.
221. *Id.*
222. *Id.*
223. *Id.*
224. *Id.*

an informed one.[225] The court found that the Time Board was adequately informed of the possible advantages of a transaction with Paramount.[226] This conclusion was based on the factual record which demonstrated that Time had previously explored and then rejected Paramount as a suitable candidate for meeting its corporate goals.[227] Moreover, the court stated that Time was not under a duty to negotiate with Paramount.[228] In its reasoning, the court agreed with the chancellor's finding that Time's extensive search for a merger partner, which included Paramount, made it unnecessary for Time to stall its plans with Warner to reevaluate Paramount.[229] Therefore, the board's decision that the tender offer presented a threat, and its refusal to negotiate with Paramount, was not uninformed.[230] It should be noted that the court found it significant that the majority of Time's Board was composed of outside, independent directors.[231]

The court next analyzed the board's decision to restructure the initial transaction and to adopt various protective defensive devices in order to determine whether the second prong of *Unocal* was satisfied. This prong requires that any defensive measures taken are reasonable in relation to the threat posed.[232] The court pointed out that in order to assess the reasonableness of a defensive measure, it is critical to first precisely identify "the nature of the threat."[233] Accordingly, the court noted the chancellor's conclusion that Time reasonably viewed the Paramount offer to be a "significant threat" to the preplanned merger with Warner.[234]

The court then addressed Paramount's argument that, even if the tender offer was a legitimate threat, the board's response was unreasonable because it foreclosed Time's shareholders from ten-

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225. *Id.*

226. *Id.* at 1154.

227. *Id.*

228. *Id.* (citing *Unocal*, 493 A.2d at 954-55).

229. *Id. See supra* note 58 (listing the other studios that Time considered and the reasons that Warner was the preferred candidate).

230. *Paramount*, 571 A.2d at 1154.

231. *Id.* The first prong of *Unocal* places the burden upon the board to demonstrate good faith and reasonable investigation in the face of a takeover. However, the supreme court has stated that "[s]uch proof is materially enhanced . . . by the approval of a board comprised of a majority of outside independent directors . . . ." *Unocal*, 493 A.2d at 955.

232. *See Unocal*, 493 A.2d at 955. *See also supra* text accompanying notes 27-29 (describing the second prong of the *Unocal* analysis).

233. *Paramount*, 571 A.2d at 1154.

234. *Id.*

dering their shares or obtaining a "control premium" in the near future.[235] In rejecting this contention, the court stated that Delaware law charges the directors, not the stockholders, with the duty to manage the affairs of the corporation.[236] Moreover, this duty encompasses determining the appropriate time period for accomplishing the corporate goals.[237] The directors are only obligated to forego a preexisting corporate strategy in order to capture a short-term profit for shareholders when there is absolutely no reason to maintain such a strategy.[238]

After clarifying this basic concept of corporate governance, the court focused on whether Time's response to the Paramount offer was proportionate to the threat of nonconsummation of the Warner merger. The court stated that, even where a legitimate threat exists, any board actions that are deemed to be coercive or force a management-proposed alternative on the shareholders may be invalidated as unreasonable under the second prong of *Unocal*.[239] The court then affirmed the chancellor's ruling that Time's response to the Paramount tender offer was proportionate.[240] Specifically, the court affirmed the chancellor's ruling that the restructuring of the initial merger agreement, and the adoption of the protective defensive devices, were not designed to force a management-proposed alternative upon the shareholders.[241] Instead, the board's response was

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235. *Id.*

236. *Id.* (citing DEL. CODE ANN. tit. 8, § 141(a) (1983)). *See supra* note 13 (quoting pertinent language of statute). *Compare* Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1989) *with* Moran v. Household Int'l, Inc., 490 A.2d 1058 (Del. Ch. 1985), *aff'd*, 500 A.2d 1346 (Del. 1985). In *Moran*, the court addressed the validity of a preferred stock rights dividend plan ("poison pill") adopted by the board of directors. The vice-chancellor stated:

> [A]lthough the [poison pill] may indeed have the effect of limiting a shareholder's ability to consider takeover proposals, shareholders do not possess a contractual right to receive takeover bids. The shareholders' ability to gain premiums through takeover activity is subject to the good faith business judgment of the board of directors in structuring defensive tactics.

Moran, 490 A.2d at 1070.

237. *Paramount*, 571 A.2d at 1154.

238. *Id. See, e.g.*, Revlon v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

239. *Paramount*, 571 A.2d at 1154 (citing Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1988); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986)).

240. *Id.* at 1155.

241. *Id.* at 1154-55 (citing Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1988); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986)).

to ensure that a preexisting transaction, although in a revised form, was consummated.[242] In addition, the court noted the chancellor's finding that Paramount was not prevented from either making an offer for the consolidated entity or removing its condition that Time and Warner terminate the planned merger.[243] Consequently, the court affirmed that the board's response was reasonable and proportionate to the perceived threat.[244]

Lastly, the court noted that Time was required to incur substantial debt to effectuate the revised transaction with Warner.[245] However, the court stated that this isolated fact does not support a finding of unreasonableness, as long as it was reasonable for the board to conclude that such debt would not harm the corporation.[246] The Time Board's actions taken to defeat the Paramount tender offer were afforded the protection of the business judgment rule.

IV. EVALUATION

A. *The* Revlon *Analysis*

Before determining that the two-part threshold test of *Unocal* was the sole standard of review under the facts of this case, it was necessary for both the chancery and the supreme courts to find that the original merger agreement did not invoke the *Revlon* duties. However, each court supported its decision that *Unocal* was the sole standard applicable with different rationales. Consequently, the supreme court's opinion clarifies the precise circumstances that will trigger the *Revlon* duties.

Generally, a board is charged under *Revlon* with the single duty to maximize current share values when it explicitly resolves to sell

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242. *Id.* at 1155. The court noted that the chancellor considered Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 257 (Del. Ch. 1989), to be analogous to the present case. In *Shamrock*, the court upheld the validity of an ESOP. The ESOP was a preexisting plan that was altered, in part, to thwart a takeover attempt. *Paramount*, 571 A.2d at 1155 n.19. *See supra* text accompanying notes 157-63 (discussing the facts and holding of *Shamrock* and the chancellor's comparison with the instant case).

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

244. *Id.*

245. *Id.* Time would incur a minimum of $7 billion in new debt to finance its acquisition of Warner. *Paramount*, No. 10,866, slip op. at 39-40, *reprinted in* 15 DEL. J. CORP. L. at 727.

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

the corporation or to effectuate a transaction that will result in the corporation's inevitable break-up or dissolution.[247] Additionally, *Revlon* duties may be triggered when a board enters into a transaction that represents a change in control.[248]

The chancery court applied this "change of control" analysis and concluded that the Time directors did not invoke the duties imposed under the *Revlon* auction rule.[249] The chancellor's conclusion that the Time-Warner transaction did not represent a change in control, and thus that the *Unocal* test was applicable, is consistent with other decisions construing the *Revlon* command.[250] The Delaware Supreme Court in *Mills Acquisition Co. v. Macmillan, Inc.*,[251] indicated that a board may be subject to *Revlon* duties even though there is no express decision to "sell" the corporation.[252] For example, a sale may be "an active auction, a management buyout, or a 'restructuring' such as that which the [c]ourt of [c]hancery enjoined in *Macmillan I*."[253] Specifically, in *Robert M. Bass Group, Inc. v. Evans*[254] (*Macmillan I*), the chancery court enjoined a defensive restructuring because it did not satisfy the two-prong *Unocal* test. The restructuring contemplated a division of the target corporation into two companies, with incumbent management acquiring control of 39% of one of the companies.[255] The chancery court found that, although the restructuring was "not a sale of an absolute majority interest," it did amount to a "sale of effective control."[256]

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247. *See Revlon*, 506 A.2d at 182 (stating that, when directors of a corporation decide to conduct a public sale of the company, their role is to achieve the best price for the shareholders).

248. *Paramount*, No. 10,866, slip op. at 59, *reprinted in* 15 DEL. J. CORP. L. at 739. *See infra* notes 251-57 and accompanying text (discussing the application of *Revlon* in a change of control situation).

249. *Paramount*, No. 10,866, slip op. at 58-60, *reprinted in* 15 DEL. J. CORP. L. at 738-40.

250. *Id. See* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1988).

251. 559 A.2d 1261 (Del. 1988).

252. *Id.* at 1285.

253. *Id.* (citing *Revlon*, 506 A.2d at 181-82).

254. 552 A.2d 1227 (Del. Ch. 1988).

255. *Id.* at 1246.

256. *Id.* at 1242. In holding that the restructuring was a "transfer of effective control" which would require a control premium, the chancellor reasoned that management would have voting control of the company. *Id.* at 1243. Regarding the restructuring plan that the chancery court enjoined in *Macmillan I*, the supreme court stated: "By any standard[s] this company was for sale . . . in *Macmillan I* . . . ." *Macmillan*, 559 A.2d at 1285.

Each type of transaction that the supreme court identified in *Macmillan* as being a "sale" of the corporate entity contemplated a shift in corporate control.[257] This lends support to the chancery court's interpretation of a sale as a change in control. After finding that no control block of shares would be exchanged if the initial Warner stock-for-stock merger transaction was actually consummated, the chancery court could not conclude that the transaction constituted a decision by the board of directors either to explicitly or implicitly sell the corporation.[258] Thus, the chancellor held that the Time Board did not have a duty to maximize current share values.[259]

A review of the types of transactions exemplified in *Macmillan* shows that the chancery court was justified in limiting the application of the *Revlon* rule to either public sales or other transactions that result in a change of control. The court's further finding that a consummation of the initial merger agreement would not have constituted a change in control is also justified by the fact that the shares of the combined entity would remain in the market, as the stock of both corporations was largely held by public investors.[260]

In affirming that the chancellor was correct as a matter of law in concluding that *Revlon* did not apply, the court also confirmed the chancellor's interpretation of *Macmillan*.[261] Specifically, the court confirmed that directors do not have to resolve explicitly to sell the corporation to invoke the *Revlon* duties.[262] Moreover, the decision in *Paramount* implicitly confirms that board approval of a transaction that results in a change of control will be deemed to constitute a sale of the corporation, and thus *Revlon* duties will be imposed upon the directors.[263]

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257. *See supra* text accompanying notes 251-56 (stating the types of transactions that will be considered a "sale" subject to *Revlon* duties).

258. *Paramount*, No. 10,866, slip op. at 58-59, *reprinted in* 15 DEL. J. CORP. L. at 739.

259. *Id.*, slip op. at 59, *reprinted in* 15 DEL. J. CORP. L. at 739.

260. *Id.*, slip op. at 59-60, *reprinted in* 15 DEL. J. CORP. L. at 739. The chancellor stated that if Warner was a private corporation, the initial stock-for-stock merger would be considered a change of control. Thus, it follows that the *Revlon* duties would be implicated. *Id.*, slip op. at 59, *reprinted in* 15 DEL. J. CORP. L. at 739.

261. *Paramount*, 571 A.2d at 1150-51; *Paramount*, No. 10,866, slip op. at 57-59, *reprinted in* 15 DEL. J. CORP. L. at 738-39.

262. *Paramount*, 571 A.2d at 1150. *See Paramount*, No. 10,866, slip op. at 58, *reprinted in* 15 DEL. J. CORP. L. at 738.

263. *Paramount*, 571 A.2d at 1150. *See Paramount*, No. 10,866, slip op. at 58, 59, *reprinted in* 15 DEL. J. CORP. L. at 739. The supreme court noted that the

Although the supreme court found that the chancellor was correct as a matter of law in his *Revlon* analysis, it seized this opportunity to clarify the situations in which the *Revlon* duties will be invoked.[264] The court stated that, as a general matter, *Revlon* will apply in only two situations. The first situation is when the corporation initiates its own sale or reorganizes and a corporate break-up results.[265] In the second situation, the corporation, as a defensive response, foregoes its long-term business plan and explores another transaction that includes a break-up of the corporation.[266] The court further clarified *Revlon* by stating that *Unocal* duties are imposed upon a board when its response to a hostile tender offer is purely defensive and is not "an abandonment of the corporation's continued existence."[267]

The initial Time-Warner agreement did not involve a self-initiated sale, a reorganization that included a corporate break-up, or a rejection of Time's long-term business plan coupled with a corporate break-up.[268] Therefore, by limiting the application of *Revlon*, the court could not conclude that Time's initial negotiations with Warner triggered the *Revlon* auction rule.

The court's *Revlon* analysis is clear: unless there is either a sale or the corporation breaks up, *Revlon* is not invoked.[269] Under this

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chancellor based his conclusion on a finding that "[b]efore the merger agreement was signed, control of the corporation existed in a fluid aggregation of unaffiliated shareholders representing a voting majority—in other words, in the market." *Paramount*, 571 A.2d at 1150.

264. The supreme court acknowledged not only that the chancellor's fact findings were supported by the record but that "his conclusion is correct as a matter of law." *Paramount*, 571 A.2d at 1150. The court, however, decided to dispose of the plaintiffs' *Revlon* contention with different rationale. *Id.*

265. *Id.* See, e.g., Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1988), as an example of the first *Revlon* situation. In *Macmillan*, there was an express decision by the target's board to put the entire company up for sale after its alternative restructuring plan was preliminarily enjoined by the chancery court. *Id.* at 1282.

266. See Revlon v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986), as an example of the second *Revlon* situation. In *Revlon*, the court stated that "when the board responded to Pantry Pride's offer by contemplating a 'bust-up' sale of assets in a leveraged acquisition, we imposed upon the board a duty to maximize immediate shareholder value and an obligation to auction the company fairly . . . ." *Id.* at 175.

267. *Paramount*, 571 A.2d at 1150-51. *See, e.g.*, *Ivanhoe Partners*, 535 A.2d at 1345 (stating that the *Revlon* auction rule is applicable only if the record supports a finding that the sale of the target was "inevitable").

268. *See supra* notes 57-84 and accompanying text (detailing the original Time-Warner agreement).

269. *Paramount*, 571 A.2d at 1150.

clarification of *Revlon*, the court could easily reject the plaintiffs' argument that *Revlon* applied because certain board members were concerned that the transaction may be perceived as either putting Time "in play" or "up for sale."[270]

The court also rejected the notion that the "structural safety devices"[271] that Time adopted to safeguard the initial agreement precluded a future control premium and, therefore, triggered *Revlon*.[272] The court agreed with the chancellor that it is settled law in Delaware that the mere adoption of defensive measures is to be reviewed solely under *Unocal*.[273]

In addressing the argument that the revised merger agreement invoked the *Revlon* duties, the court noted that Time did not abandon its existing plan or make a sale of the corporation inevitable.[274] The court agreed with the chancellor that a future takeover of the combined entity was not impossible and, therefore, only the *Unocal* duties applied to the restructuring of the merger.[275]

The court's *Revlon* analysis makes clear when directors have a duty to maximize current share values. It is now apparent that if a corporation remains steadfast in achieving its long-term goals in the face of a takeover, and does not propose a corporate break-up, *Revlon* will not be implicated. In this situation, defensive actions taken on the part of the board will be reviewed under the enhanced *Unocal* standard.[276]

B. *The* Unocal *Analysis*

Before applying *Unocal* to the defensive actions taken after the Paramount offer emerged, the supreme court concluded that the

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270. *Id.* at 1151. *See* Citron v. Fairchild Camera, 569 A.2d 53 (Del. 1989); *Macmillan*, 559 A.2d at 1285 n.35. *See also supra* note 190 (discussing the supreme court's reasoning in *Macmillan*).

271. The "structural safety devices" that the court referred to are the "lock-up agreement," the "dry-up agreements," and the "no-shop clause." *Paramount*, 571 A.2d at 1151. *See also supra* text accompanying notes 80-84 (describing these protective devices).

272. *Paramount*, 571 A.2d at 1151.

273. *Id.*

274. *Id.* The court was impressed that the Time directors did not decide to adopt another alternative to Paramount's offer, but preferred to go forward with the Warner transaction. *Id.* at 1151 n.16.

275. *Id.* at 1151 (citation omitted). It should be noted that the chancellor indicated that a successful acquisition of the consolidated company not only would be large but may be unlikely as a practical matter. *Paramount*, No. 10,866, slip op. at 57, 76, *reprinted in* 15 DEL. J. CORP. L. at 738, 749.

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

board's initial decision to merge with Warner was protected by the business judgment rule.[277] In support of this conclusion, the court stated that it deliberately chronicled the course that the Time Board pursued prior to its decision to merge with Warner.[278] The court considered it significant that the decision to expand was reached in 1983 after carefully evaluating the future of Time.[279] Furthermore, the court was impressed with the fact that an extensive search of the available entertainment concerns was conducted prior to Time's selection of Warner as its preferred partner.[280] The court was also impressed that, from the outset, both the executives and directors were adamant in their desire to maintain Time's corporate culture.[281] The significance the court attributes to these facts permeates the court's *Unocal* analysis of the revised transaction and its ultimate decision to affirm the chancellor's ruling.

Prior to applying *Unocal* to Time's defensive measures, the court noted its disagreement with certain chancery court decisions on which the plaintiffs relied. In *Interco* and *Pillsbury*, the chancery court proposed that an all-cash, all-shares tender offer, within a range of values that a shareholder may prefer, does not constitute a legitimate threat to the corporate entity.[282] Therefore, any defensive measures that preclude a target's shareholders from tendering their shares will be deemed a disproportionate response and will not survive the required *Unocal* analysis.[283]

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277. *Id.* at 1152.

278. *Id.* at 1151. *See also id.* at 1143-49 (giving the supreme court's recitation of the facts giving rise to the controversy).

279. *Id.* at 1151-52. *See supra* notes 48-55 and accompanying text (describing Time's decision to expand and its corporate culture).

280. *Paramount*, 571 A.2d at 1152. *See supra* note 58 (listing the entertainment studios that Time investigated prior to selecting Warner and discussing the reasons Warner was the preferred candidate).

281. *Paramount*, 571 A.2d at 1152. *See supra* notes 54-55 (describing Time's corporate culture). *See also supra* notes 58-67 (chronicling the consistent desire on the part of the board to ensure the Time culture remained intact).

282. *Paramount*, 571 A.2d at 1152. The court stated that these decisions suggested such offers "cannot constitute a legally recognized 'threat' to shareholder interests sufficient to withstand a *Unocal* analysis." *Id.* (citations omitted). *See* Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988); City Capital Assocs. Ltd. v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988). *See also infra* note 283 (discussing *Interco* and *Pillsbury*).

283. In *Interco*, the directors of a target corporation refused to redeem defensive stock rights as a defense against an all-shares, all-cash tender offer that they found inadequate. *Interco*, 551 A.2d at 789. After the emergence of the tender offer, the board also proposed a restructuring of the corporation which included a substantial

As the plaintiffs argued, the Paramount tender offer was for all cash and all shares and was, therefore, noncoercive.[284] In addition, the chancery court found that the market price of the Time shares soon after the merger was not likely to reach the initial $175 per share price of the Paramount offer.[285] This finding suggests that the Paramount proposal was within the range of values that a shareholder may prefer. Furthermore, the Paramount offer was contingent upon the termination of the Warner transaction and, by consummating that transaction, the Time shareholders would be foreclosed from accepting the tender offer.[286] Based on these facts, it appears that the only threat the Paramount offer posed was to the shareholders' economic interests. In light of the *Interco* and *Pillsbury* holdings, the board's decision to reformat the merger transaction could be deemed

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sale of assets, a large dividend distribution, and a heavy debt. *Id.* at 793. The tender offer was for $74 per share, while the proposed restructuring was valued at $76 per share. The court stated that in an all-cash, all-shares tender offer situation, there is no threat posed to corporate policies, "but rather the threat, if any, is most directly to shareholder interests." *Id.* at 797. The threat posed to shareholders relates to the "substantive, economic interest represented by the stockholding." *Id.* The court found that the tender offer was not an adequate threat to the shareholders' interests that justified precluding them from the option to accept that offer. *Id.* at 799. Therefore, allowing the rights plan to remain was not a reasonable defensive measure in relation to the threat posed. However, it should be noted that the court found the restructuring proposed by the board was a reasonable response to the tender offer as the offer was thought to be inadequate. *Id.* at 790-91.

In *Pillsbury*, the directors of a target corporation declined to redeem a poison pill when confronted with an all-cash, all-shares tender offer they claimed was inadequate. *Pillsbury*, 558 A.2d at 1052. The tender offer was contingent upon the redemption of the poison pill. In response, the directors proposed a plan to sell substantial corporate assets in the hope of achieving greater long-term value for the corporation's shareholders. *Id.* at 1057. The tender offer was for $65 per share, while the board's plan presented the possibility of achieving $68 over a five-year period. *Id.* at 1057 n.9. The court applied the *Unocal* analysis and found that the only threat presented was to shareholder value and not to the corporate enterprise. *Id.* at 1058. Since shareholder value was considered to be the only "threat posed," the board's decision not to redeem the poison pill was found to be unreasonable because its only purpose was to foreclose the shareholders from tendering their stock at a higher current value. *Id.* at 1060.

284. *Paramount*, 571 A.2d at 1152-53.

285. *Paramount*, No. 10,866, slip op. at 2, *reprinted in* 15 DEL. J. CORP. L. at 707. Based on this finding, it follows that it was also unlikely that the market price of Time shares would reach the $200 price offered by Paramount following the completion of the Warner transaction. *Id.*

286. *Id.*, slip op. at 26, *reprinted in* 15 DEL. J. CORP. L. at 720. The chancellor noted that this condition was self-imposed by Paramount. Therefore, the Paramount and the Warner transactions were not in fact alternative proposals. *Id.*, slip op. at 73, 74, *reprinted in* 15 DEL. J. CORP. L. at 747.

unreasonable as it prevented Time's shareholders from accepting the offer.

The supreme court disposed of this argument by expressly rejecting the rationale of *Interco* and *Pillsbury*, stating that these decisions were based on an improper application of *Unocal*.[287] The court reasoned that by engaging in a comparative share value analysis and determining which is the superior value, the court is "substituting its judgment as to what is a 'better' deal for a corporation's board of directors."[288] The court also stressed that a proper *Unocal* review requires an "open-ended analysis" and not a "simple mathematical exercise."[289] Furthermore, any analysis which requires an evaluation of the benefits of a "long-term versus a short-term investment goal for shareholders" undermines the concepts upon which the business judgment rule is founded.[290]

The court's rejection of *Interco* and *Pillsbury* demonstrates that preservation of a preexisting corporate strategy is a proper consideration in appraising the threat presented by an uninvited all-cash, all-shares tender offer. As a result, the court found that the Time Board was reasonable in concluding that the Paramount offer posed more than the threat of inadequate share value.[291] The Delaware Supreme Court recognized that the following effects of the Paramount offer posed a legitimate threat to Time's corporate policy: (1) the shareholders may have tendered their shares without sufficient knowledge of the potential benefits of the Warner transaction; (2) the uninvited tender offer imposed "uncertainty" and slanted a comparative analysis; and (3) the offer was timed to disrupt and add confusion to the scheduled shareholder vote.[292] By concluding that these facts constitute a legitimate threat to Time's corporate policy,

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287. *Paramount*, 571 A.2d at 1153.

288. *Id.* The court stated that "to the extent that the [c]ourt of [c]hancery has substituted its judgment for that of the board in certain of its opinions, we hereby reject such approach as not in keeping with a proper *Unocal* analysis." *Id.*

289. *Id.*

290. *Id. See supra* note 21 (discussing the policy behind the business judgment rule). In its opinion, the supreme court also stated that Delaware directors are charged by statute with the duty to manage the business and affairs of the corporation, and this duty encompasses the appropriate time frame for maximizing corporate profits. *Paramount*, 571 A.2d at 1150. *See* cases cited *supra* note 15 (discussing the business judgment rule and the purpose of DEL. CODE ANN. tit. 8, § 141(a) (1983)).

291. *Paramount*, 571 A.2d at 1153.

292. *Id.*

the court proposes that protecting a preplanned transaction is a legally recognizable consideration under *Unocal*.

At first glance, this holding suggests that mere proof of the existence of a prior business plan will provide sufficient evidence to satisfy the first prong of *Unocal*. However, to satisfy this prong, the directors must also demonstrate that their evaluation of the threat presented was based on "good faith and reasonable investigation."[293] The court found that Time's directors were informed when they concluded that the uninvited offer was a threat to corporate policy, notwithstanding their failure to negotiate with Paramount.[294] This finding was based on Time's diligence in searching for a compatible partner, prior to its selection of Warner.[295] In addition, the court found it significant that the majority of Time's Board was composed of outside directors.[296] All of these facts enabled the board to satisfy its burden under the first prong of *Unocal*.

With respect to the second prong of *Unocal*, the court held that Time's reformatting the merger was a reasonable response to the threat presented by Paramount's offer.[297] The court suggested that foreclosing shareholders from receiving a future change in control premium is not per se unreasonable.[298] This is because under Delaware law it is the directors' duty to manage the business and affairs of the corporation.[299] The court made clear that this duty entails choosing the appropriate timetable for accomplishing the corporate strategy.[300] The court emphasized that "[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."[301] This statement alone highlights the importance the court attached to both Time's preexisting plan, considered by the board as critical to the corporation's future success, and its desire to remain an independent concern.

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293. *Id.* at 1152. *See Unocal*, 493 A.2d at 955 (quoting *Cheff*, 199 A.2d at 555).

294. *Paramount*, 571 A.2d at 1154.

295. *Id.* The court stated, "[T]he record does, in our judgment, demonstrate that Time's [B]oard was adequately informed of the potential benefits of a transaction with Paramount." *Id.*

296. *Id.* (citing *Moran*, 500 A.2d at 1356; *Unocal*, 493 A.2d at 955).

297. *Id.* at 1155.

298. *Id.* at 1154.

299. *Id.* (citing DEL. CODE ANN. tit. 8, § 141(a) (1983)). *See supra* note 13 (quoting pertinent text of the statute).

300. *Paramount*, 571 A.2d at 1154.

301. *Id.*

In addressing the second prong of *Unocal*, the supreme court stated that, although a hostile offer may present a legitimate threat to corporate policy, board actions that force a management alternative upon the shareholders may be invalidated as a disproportionate response.[302] This statement is significant as the court affirmed the chancellor's finding that the goal of the revised Time-Warner transaction was to preserve a preexisting business plan and not geared toward coercing a management-sponsored alternative upon the shareholders.[303] Thus, the court upheld the validity of the revised transaction under the second prong of *Unocal*.

In light of the fact that the Paramount offer was conditioned upon the termination of the Time-Warner merger, and the revised transaction was designed to dispose of the upcoming shareholder vote, it can be argued that the board was indeed forcing a management-sponsored alternative upon the shareholders. However, this argument is weakened, and the court's ultimate conclusion may be justified, as the Time-Warner transaction had its genesis in a preexisting plan and not in matters of corporate control.[304] These facts also distinguish the instant case from *Interco* and *Pillsbury*.[305] In those chancery court decisions, it was found that the poison pills were strictly defensive measures and did not serve any other business purpose.[306] Therefore, this decision suggests that when a board is seeking to protect a preplanned transaction, with the future success of the corporation as its end result, the presumption of an entrenchment motive is weakened.

The court was also satisfied that the restructuring of the Time-Warner merger with its protective devices did not prevent Paramount from a successful takeover attempt of the consolidated entity or from

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302. *Id.* (citing Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1988); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103 (Del. Ch. 1986)).

303. *Id.* at 1154-55.

304. *Paramount*, No. 10,866, slip op. at 73, *reprinted in* 15 DEL. J. CORP. L. at 747.

305. *Id.* In distinguishing the *Interco* and *Pillsbury* decisions, the chancellor stated: "[T]he revised transaction, even though 'reactive' in important respects, has its origin and central purpose in *bona fide* strategic business planning, and not in questions of corporate control." *Id. See supra* note 283 (discussing the facts and holdings of *Interco* and *Pillsbury*).

306. *See Pillsbury*, 558 A.2d at 1060 (poison pill served no purpose except to prevent shareholders from accepting tender offer); *Interco*, 551 A.2d at 798 (the only function remaining for the poison pill was to prevent shareholders from accepting a noncoercive tender offer).

dispensing with its condition that Time terminate the planned merger.[307] Consequently, the supreme court concluded that the board's actions were reasonable responses to the threat presented by the Paramount tender offer and, therefore, the board's decision was protected by the business judgment rule.[308]

It is clear that the court's analysis under the first prong of *Unocal* establishes that an all-cash, all-shares tender offer at an adequate price can constitute a legally cognizable threat to corporate policy.[309] The court's analysis under the second prong of *Unocal* establishes that restructuring a preexisting transaction to prevent a hostile offer will be deemed a proportionate response and, therefore, satisfy the second prong of *Unocal*.[310] However, the court did not address whether a defensive response to an all-cash, all-shares tender offer at an adequate price will satisfy the mandate of *Unocal* in the absence of a preexisting corporate plan.

For example, in both *Interco* and *Pillsbury*, the chancery court invalidated nonredemption of both targets' poison pills as unreasonable responses because their only purpose was to prevent the shareholders from tendering their shares at an acceptable value.[311] According to *Paramount*, the court is not to engage in a comparative analysis of share values to determine the reasonableness of the target's defensive measures.[312] It is now unclear, therefore, what rationale can properly support a finding of unreasonableness on the part of the board when confronted with an all-cash, all-shares tender offer within an acceptable range of value. In the absence of a preexisting corporate plan implemented by the target, perhaps the court will look to whether the adoption of the defensive measures serve any *other* business purpose.[313] Exactly what will constitute a proper business purpose is

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307. *Paramount*, 571 A.2d at 1155; *Paramount*, No. 10,866, slip op. at 76, *reprinted in* 15 DEL. J. CORP. L. at 749.

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

309. *Id.* at 1142, 1153.

310. *Id.* at 1154.

311. *See supra* note 283 and accompanying text (discussing the facts and holdings of *Interco* and *Pillsbury*).

312. *Paramount*, 571 A.2d at 1153.

313. The chancellor suggests this proposition by stating "in my view, a decision not to redeem a poison pill, which *by definition* is a control mechanism and not a device with independent business purposes, may present distinctive considerations than those presented in this case." *Paramount*, No. 10,866, slip op. at 77 n.22 (emphasis added), *reprinted in* 15 DEL. J. CORP. L. at 749 n.22. *See* Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 257 (Del. 1989) (an ESOP adopted prior to a takeover but enlarged as a defensive response upheld as valid). *See also supra* text accompanying notes 157-60 (discussing the facts and holding of *Shamrock*).

unclear. With *Paramount* as a guide, Delaware corporations will now be inclined to develop carefully long-term corporate plans in order to ensure that the adoption of defensive measures in direct response to an all-cash, all-shares tender offer of adequate value will satisfy the mandate of *Unocal*.[314]

V. CONCLUSION

In general, *Paramount* has clarified the types of defensive measures that will be upheld by the court when a target corporation is responding to a takeover attempt. It seems clear that an all-cash, all-shares tender offer will not automatically be considered as a threat only to the shareholders' current economic interests regarding price. If the directors can show that their defensive reaction was specifically designed to ensure that the corporation's preexisting strategic goals are accomplished, they will be deemed to have a justifiable corporate interest to protect. Hence, the first prong of the *Unocal* analysis will be satisfied.

In addition, if the defensive reaction is designed to preserve this preexisting goal, and it does not make a future takeover attempt impossible or the dissolution or break-up of the corporation inevitable, it will be considered reasonable in relation to the threat posed. Hence, the second prong of the *Unocal* analysis will be satisfied, and the directors' actions in responding to a takeover attempt will be protected by the business judgment rule.

Specifically, the court's decision illustrates the factors that the court will be most persuaded by in upholding a defensive decision made by a board of directors when faced with a takeover attempt. If the transaction has an independent business purpose and was planned prior to the emergency of the takeover attempt, the court will uphold the validity of the transaction.

The court's decision, however, does not address whether a strictly defensive response to an all-cash, all-shares tender offer at an adequate value will be deemed a proportionate response in the absence of a preexisting plan. Thus, one wonders if this is truly a decision of paramount significance.

Lisa A. Duda

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314. *The* Time-Warner *Decision*, Insights, 4 CORP. & SEC. L. REP. (P-H) No. 6, at 31-32 (June 1990).