THE REBIRTH OF THE TENDER OFFER? *PARAMOUNT COMMUNICATIONS, INC. V. QVC NETWORK, INC.*

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I. INTRODUCTION

Commentators have intensely debated the appropriate degree of scrutiny courts should use to review target directors' responses to hostile tender offers.[1] Commentators have propounded widely varying views,

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[1]A number of commentators argue that courts should deny target directors the opportunity to use any defenses. *See* Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981) [hereinafter Easterbrook & Fischel, *Proper Role*]; Frank H. Easterbrook & Daniel R. Fischel, *Auctions and Sunk Costs in Tender Offers*, 35 STAN. L. REV. 1 (1982) [hereinafter Easterbrook & Fischel, *Auctions*]; *see also* Ronald J. Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, 35 STAN. L. REV. 51, 52 (1982) ("[T]here is no coherent justification for allowing target management to engage in defensive tactics that may deprive shareholders of the opportunity to tender their shares."); Lucian A. Bebchuk, Comment, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028 (1982) [hereinafter Bebchuk, Comment] (discussing factors which justify prohibiting target management from using defensive tactics); Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers: A Reply and Extension*, 35 STAN. L. REV. 23, 47 (1982) [hereinafter Bebchuk, *A Reply*] ("[D]efensive tactics should be prohibited; a target's shareholders should be completely free to accept the best offer made to them."); Lucian A. Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693, 1744 (1985) [hereinafter Bebchuk, *Toward Undistorted Choice*] (suggesting that "allowing obstructive [defensive] tactics leads to wasteful expenditures and falls far short of attaining undistorted choice"). Commentators on the other end of the spectrum argue for a business judgment review of target defenses. *See* Leo Herzel et al., *Why Corporate Directors Have a Right to Resist Tender Offers*, 3 CORP. L. REV. 107 (1980); Martin Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1 (1987) [hereinafter Lipton, *Corporate Governance*]; Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101 (1979) [hereinafter Lipton, *Takeover Bids*]; Martin Lipton, *Takeover Bids in the Target's Boardroom; An Update After One Year*, 36 BUS. LAW. 1017 (1981); Martin Lipton & Andrew R. Brownstein, *Takeover Responses and Directors' Responsibilities — An Update*, 40 BUS. LAW. 1403 (1985). Predictably, other commentators advocate intermediate positions. *See* John C. Coffee, Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145 (1984); Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247 (1989); Dale A. Oesterle, *The*

ranging from arguments that courts should require target directors to remain entirely passive[2] to claims that courts should permit target directors to use a broad array of defensive tactics.[3] Despite the fact that both Congress[4] and a number of state legislatures[5] have adopted laws in this area, the validity of target defenses remains largely a function of state common law.[6]

The debate over tender offer defenses obscures one central point of agreement: the tender offer is a significant economic development.[7] However, the various arguments regarding appropriate judicial treatment of tender offer defenses reflect diametrically opposed views regarding the economic impact of hostile bids. Commentators urging courts to limit target directors' defensive responses offer evidence that tender offers are value creating transactions[8] which encourage efficient corporate management.[9]

Negotiation Model of Tender Offer Defenses and the Delaware Supreme Court, 72 CORNELL L. REV. 117 (1986); Joel Seligman, *The New Corporate Law*, 59 BROOK. L. REV. 1 (1993).

[2]*See* Easterbrook & Fischel, *Proper Role*, *supra* note 1.

[3]*See* Lipton, *Takeover Bids*, *supra* note 1.

[4]Congress adopted the Williams Act in 1968 to govern tender offers. *See* Pub. L. No. 90-439, 82 Stat. 454 (codified as amended at 15 U.S.C. §§ 78m(d)-78m(e), 78n(d)-78n(f) (1988). Legislative history suggests that Congress intended to remain neutral as between hostile bidders and target corporations. *See* 5 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION 2163-67 (3d ed. 1990).

[5]*See, e.g.*, *infra* notes 15 & 185.

[6]*See* Lyman Johnson & David Millon, *Does the Williams Act Preempt State Common Law in Hostile Takeovers?*, 16 SEC. REG. L.J. 339, 341 (1989) ("[T]he common law's . . . fiduciary strictures and the closely related business judgment rule have been central to judicial efforts to untangle the nettlesome issue of appropriate behavior by target company management.").

[7]A relatively new phenomenon in the 1960s, tender offers "shook corporate America to its very core and epitomized Wall Street in the eighties." Michael Bradley, *SEC Neglect and the Extinction of the Hostile Takeover*, *in* MODERNIZING U.S. SECURITIES REGULATION: ECONOMIC AND LEGAL PERSPECTIVES 293, 293 (Kenneth Lehn & Robert W. Kamphuis, Jr. eds., 1992). "The first hostile tender offer by one New York Stock Exchange listed corporation for another is generally dated back to only a decade ago — a date well after the passage of the Williams Act." Coffee, *supra* note 1, at 1205 (footnote omitted).

[8]There is strong evidence that successful tender offers are wealth-creating transactions. One study indicates that the combined abnormal returns — a measure of stock values independent of market trends — of bidder and target stock subsequent to successful tender offers is consistently positive, with most of the value going to target stockholders. Michael Bradley et al., *Synergistic Gains from Corporate Acquisitions and their Division between the Stockholders of Target and Acquiring Firms*, 21 J. FIN. ECON. 3, 12, 25-30 (1988) [hereinafter Bradley et al., *Synergistic Gains*]; *see also* Easterbrook & Fischel, *Proper Role*, *supra* note 1, at 1184-88 (arguing that stockholders acquire the majority of funds used to finance a tender offer); Gilson, *supra* note 1, at 61 n.24 ("The data is thus consistent with the presence of some transactions which do not reflect real gains but which are outweighed by those that do."). *But cf.* Coffee, *supra* note 1, at 1221-50 (discussing potential "diseconomies" of tender offers).

Professors Bradley, Desai, and Kim suggest that value creation in tender offers is the result of "synergy." Michael Bradley et al., *The Rationale Behind Interfirm Tender Offers: Information or Synergy?*, 11 J. FIN. ECON. 183, 184 (1983) [hereinafter Bradley, *Rationale*].

Commentators critical of this view point out that these potential economic efficiencies come at a cost — corporate "raiders" might use the tender offer as a method to reap quick profits at the expense of the target's stockholders, employees, and surrounding community.

The Delaware Supreme Court recently made a significant contribution to the law governing tender offer defenses in *Paramount Communications, Inc. v. QVC Network, Inc.*[10] In *QVC*, the court rejected the target directors' claim that they were justified in fending off a hostile tender offer because they preferred to consummate a merger with a third corporation.[11] Instead, the court held that the target directors breached a fiduciary duty to their stockholders by refusing to consider a hostile bid which offered more consideration to the target's stockholders than the proposed merger.[12] The court ruled that when a corporation undertakes a transaction which will change corporate control or break up the corporation, the target directors have an obligation "to seek the best value reasonably available to the stockholders."[13]

This article argues that the *QVC* court's strict limitation of the target directors' discretion in response to the hostile bid was correct and should be applied generally. While target directors might use tender offer defenses to

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Synergy is the concept that corporations can combine in certain instances so that the total value is greater than the sum of the parts:

> The value created by the combination may result from more efficient management, economies of scale, improved production techniques, the combination of complementary resources, the redeployment of assets to more profitable uses, the exploitation of market power, or any number of value-creating mechanisms that fall under the general rubric of corporate synergy.

Bradley et al., *Synergistic Gains*, *supra*, at 4.

The strongest evidence of synergy in tender offers is a study which demonstrates that while the stock value of all targets of unsuccessful tender offers studied remained above the pre-offer value immediately after the unsuccessful offer, the stock only retained its inflated value if the target was eventually taken over. Bradley et al., *Rationale*, *supra*, at 193-94. "These results are consistent with the hypothesis that a successful acquisition (change in control) of the target resources is required in order to effect a permanent positive revaluation of the target shares. That is, the revaluation requires some specialized resource that is not possessed by the target firm." *Id.* at 194. *But cf.* Bebchuk, *Toward Undistorted Choice*, *supra* note 1, at 1703 (suggesting that some tender offers occur because bidders discover positive information about the target which has not yet reached the market and, consequently, is not reflected in the target stock's price).

[9]*See* Easterbrook & Fischel, *Proper Role*, *supra* note 1, at 1168-74.

[10]637 A.2d 34 (Del. 1993). Delaware law is particularly relevant in the tender offer context. "[A] substantial plurality of the nation's largest corporations are incorporated there . . . and . . . Delaware has a more highly developed corporate law case law than any other state." Seligman, *supra* note 1, at 9 n.26.

[11]*QVC*, 637 A.2d at 49-50.

[12]*Id.* at 51.

[13]*Id.* at 48.

benefit their stockholders in some instances, these defenses are difficult to distinguish from those used to promote target directors' own interests. Moreover, target directors truly interested in protecting their stockholders' interests can do so using a limited number of defenses designed to enhance target stockholders' ability to evaluate hostile bids.

This article proposes a rule limiting target directors' discretion to a narrow range of permissible tender offer defenses. Part II advances a "stockholder choice paradigm," arguing that the unique dynamics of tender offers make stockholders the best actors to evaluate tender offer defenses. Part III discusses Delaware courts' history of using heightened scrutiny to review tender offer defenses and *QVC*'s role in demonstrating that Delaware courts are moving toward a stricter interpretation of directors' fiduciary duties. Part IV proposes a rule permitting only two types of tender offer defenses — those allowing target stockholders to make an uncoerced choice between competing offers and those offering target stockholders alternatives to a hostile bid. Part IV also suggests that courts applying such a rule should require target directors using impermissible defenses to maximize value for their stockholders in an auction. This article concludes that courts could use the proposed rule to align target directors' incentives with their stockholders' interests, resolving doctrinal difficulties posed by current tender offer law.

II. STOCKHOLDER CHOICE — A PARADIGM

Courts evaluating tender offer defenses should limit the range of permissible defenses to those which enhance target stockholders' ability to evaluate competing offers. While directors are normally the appropriate decision makers regarding corporate affairs, tender offers pose a conflict of interest for directors because successful offers often displace incumbent boards. Part I(A) argues that stockholders are best positioned to determine their own interests in the tender offer context. Therefore, allowing shareholders to decide whether or not to accept an offer is most consonant with general fiduciary principles. Part I(B) describes the range of permissible target defenses under this stockholder choice paradigm.

A. *Courts Should Allow Target Stockholders to Decide Whether or Not to Accept a Tender Offer*

Under the business judgment rule, courts normally afford directors broad discretion in managing corporate affairs.[14] The business judgment rule

[14]In Delaware, the business judgment rule functions as "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." Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (citations omitted). The American Law Institute rejects framing the business judgment rule as a presumption. 1 PRINCIPLES OF CORPORATE

makes sense in the context of business decisions in which directors are not confronted with a conflict of interest. In these situations, directors serve as a proxy for stockholders,[15] making decisions calculated to maximize the stockholders' long-term wealth.[16] The duty of loyalty[17] helps to align directors' incentives with their stockholders' interests. However, this system breaks down when directors are faced with a hostile tender offer because target directors have a strong incentive to act in a self-interested way.[18]

In contrast, stockholders are fully capable of choosing between competing offers. Therefore, courts should allow target stockholders to make

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GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01(d), cmt. a, at 187 (A.L.I. 1994) [hereinafter A.L.I. PRINCIPLES], but otherwise recommends an approach which closely parallels Delaware's formulation of the rule. *See generally id.* § 4 (discussing the policy underlying the business judgment rule).

[15]A number of commentators argue that directors' duties flow to other corporate stakeholders in addition to stockholders. *See, e.g.*, William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 35 CORP. PRAC. COMMENTATOR 2 (1993); Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579 (1992). Many states have adopted statutes permitting, or even requiring, corporate directors to take these nonstockholder constituents' interests into account. James J. Hanks, Jr., *Non-Stockholder Constituency Statutes: An Idea Whose Time Should Never Have Come*, INSIGHTS, Dec. 1989, at 20, 20 (stating that 24 states have adopted such statutes). This article assumes that target directors' duties flow solely to their stockholders. Courts would have to abandon the established rubric of directors' fiduciary duties to give nonstockholder constituents' interests any real weight. *See* Committee on Corporate Laws, American Bar Association, *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253, 2253 (1990). Such a change in fiduciary duties would likely reduce directors' accountability. *See id.* at 2269; Hanks, *supra*, at 24-25. *But see* Mitchell, *supra*, at 639-40 (arguing legislatures could reformulate other constituencies statutes to effect a net increase in accountability). Moreover, many nonstockholder constituents are able to protect their perceived rights by contract. *See* Committee on Corporate Laws, *supra*, at 2268; Alexander C. Gavis, Note, *A Framework for Satisfying Corporate Directors' Responsibilities Under State Nonshareholder Constituency Statutes: The Use of Explicit Contracts*, 138 U. PA. L. REV. 1451 (1990).

[16]Delaware courts have made clear that directors' statutory authority to manage corporate affairs entails a concomitant fiduciary duty to further the interests of "the corporation and its stockholders." Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939); *see also Aronson*, 473 A.2d at 811 (citing Loft, Inc. v. Guth, 2 A.2d 225 (Del. Ch. 1938), *aff'd*, 5 A.2d 503 (Del. 1939) (stating that the director's responsibility is to further the monetary interests of the business and its stockholders)).

[17]"[D]irectors can neither appear on both sides of a transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally." *Aronson*, 473 A.2d at 812 (citations omitted).

[18]*See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985) (identifying the "omnipresent specter that a board [responding to a hostile tender offer] may be acting primarily in its own interests"); *see also infra* note 30 (discussing the possibility that directors may put their own interests before those of the stockholders).

this choice,[19] effectuating the purpose of directors' fiduciary duties — to maximize stockholder welfare.

Stockholders usually do not require directors' business expertise to determine which alternative tender offer provides the greatest value.[20] When stockholders are faced with a tender offer for a controlling block of target stock, they have no long-term interest in the corporation.[21] If the offer succeeds, stockholders' sole concern is how much immediate compensation they receive for their stock. If the offer fails and the bidder does not purchase any target stock, the stockholders do have a continuing interest in the target. Target stockholders only allow this to occur, however, if they believe the current value of target stock exceeds the bidder's offer or if they believe a higher bid is imminent.[22] Directors are almost certainly better than

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[19]Every tender offer poses a choice to target stockholders. Even if there is only one bidding firm, there are always at least two options available to target stockholders — to keep their target stock or to tender to the bidder.

[20]*See* Easterbrook & Fischel, *Proper Role*, *supra* note 1, at 1198 ("[I]n deciding whether to accept or reject a tender offer, managers enjoy no particular comparative advantage over shareholders."); *see also id.* at 1198 n.106 (arguing stockholders are capable of choosing between competing tender offers as opposed to making other business decisions). *But see* Lipton, *Takeover Bids*, *supra* note 1, at 117-20 (arguing issues other than price justify target managers' intervention in stockholders' evaluation of competing offers).

[21]*Cf. QVC*, 637 A.2d 34, 43 (Del. 1993) (noting that the target stockholders in that case had only one chance to capture a control premium); Allen, *supra* note 15, at 16 ("It is, however, rather a different thing to justify precluding the shareholders from selling their stock at a large immediate profit on the ground that in the long run it will be good for them.")

Stockholders' lack of long-term interest in targets explains the *Revlon* court's refusal to allow the target board in that case to protect nonstockholder constituents once a sale became imminent. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986); *see also* TW Servs., Inc. v. SWT Acquisition Corp., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,179 (Del. Ch. 1989), *reprinted in* 14 DEL. J. CORP. L. 1169, 1184 (1989) (holding that the board's decision not to pursue a merger which would negatively affect the company's long-range goals was in good faith and in pursuit of the company's best interest). In *TW*, the chancellor explained:

> The rationale for recognizing that non-contractual claims of other corporate constituencies are cognizable by boards, or the rationale that recognizes the appropriateness of sacrificing achievable share value today in the hope of greater long term value, is not present when all of the current shareholders will be removed from the field by the contemplated transaction.

Id. Directors necessarily deal with the concerns of nonstockholder constituents in the course of business operations. Once an imminent sale makes it clear that target stockholders are going to be cashed out, however, such long-term considerations become irrelevant to directors' function to pursue value for stockholders.

[22]*But see* Bebchuk, *Toward Undistorted Choice*, *supra* note 1, at 1723-28 (arguing that bidders are capable of coercing target stockholders to accept tender offers with a total value less than the pre-offer value of the target stock); Gilson & Kraakman, *supra* note 1, at 259-60 (arguing target stockholders may accept inadequate offers due to informational assymetries). Part I(B) of this article discusses the concerns expressed by these commentators and explains

stockholders at valuing consideration which includes securities.[23] Nevertheless, target directors should simply provide all material information about the value of such securities to their stockholders. Once they possess this information, target stockholders are capable of making comparative valuations.[24]

Stockholder choice serves two significant social functions. First, target stockholders can discipline ineffective boards by replacing them with bidders who can create more value using the target's assets.[25] Corporate managers and boards may not work to the extent of their capabilities absent some outside impetus.[26] Therefore, the threat of a hostile tender offer provides directors with an incentive to maximize stockholder value.[27] If a corporate board is lax, a hostile bidder — believing it can make more efficient use of the target's assets — may be able to offer target stockholders a premium over the target stock's market value sufficient to facilitate a successful tender offer.[28] Under this view, target directors, the objects of the

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how courts can differentiate between target directors' actions intended to minimize stockholder coercion and those which serve to entrench the incumbent board.

[23]Bidders often offer target stockholders a combination of cash and securities in exchange for target shares. Because the value of securities changes over time — especially when the issuing corporation is involved in a contest for corporate control, valuing securities offered as consideration can be a complicated task.

[24]Stockholders are capable of determining the expected value of a proposed transaction taking into account directors' descriptions of the uncertainty of a hostile bid and any other information provided by target boards. *See* Oesterle, *supra* note 1, at 124-26. *But see* Gilson & Kraakman, *supra* note 1, at 271-73 (offering several justifications for a proportionality test which demands serious justification for defensive tactics). This is especially true because professional traders with substantial expertise usually buy up most of the target stock before it is tendered to a bidder. *See* C. Steven Bradford, *Stampeding Shareholders and Other Myths: Target Shareholders and Hostile Tender Offers*, 15 J. CORP. L. 417, 456-57 (1990).

[25]Professors Easterbrook and Fischel argue that the most important benefit of tender offers is their ability to discipline inefficient corporate managers. Easterbrook & Fischel, *Proper Role*, *supra* note 1, at 1169-74. Because auctions drive up the cost of acquiring targets, they necessarily have the effect of decreasing the number of hostile acquisitions. *Id.* at 1176-80. Easterbrook and Fischel conclude that courts and legislatures should adopt rules which promote tender offers, including rules which deter auctions, to keep premiums low. *Id.* at 1199-204. They argue stockholders would prefer this result because the threat of hostile bids would encourage all corporate managers to operate efficiently. *Id.* All stockholders would benefit, not just those who fortuitously hold stock of a target corporation. *Id.* at 1173-74. *But see* Coffee, *supra* note 1, at 1294-95 (concluding that auctions are beneficial).

[26]Easterbrook & Fischel, *Proper Role*, *supra* note 1, at 1169-72 (describing managers' incentives in terms of agency costs).

[27]*Id.* at 1173-74. *But cf.* Coffee, *supra* note 1, at 1206-11 (discussing empirical evidence demonstrating that there is little correlation between the identity of target firms and inefficient managements).

[28]*See* Easterbrook & Fischel, *Proper Role*, *supra* note 1, at 1173.

discipline, are clearly not in a position to help stockholders evaluate hostile offers.

Stockholder choice serves a second socially useful function. Stockholders facilitate the movement of corporate assets to their most highly valued use by choosing the bid which offers the most consideration.[29] However, if target directors are permitted to act, they may behave in a self-interested way by favoring bidders friendly to the incumbent board.[30] Therefore, courts should strive to create legal rules which maximize stockholder choice in sales of control, thus, facilitating target assets' movement to their most highly valued use.[31]

The proposed focus on stockholder choice stems from the purposes, rather than the current form, of directors' fiduciary duties. The business judgment rule facilitates effective corporate governance by giving directors

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[29]The bidder which can make the best use of the target's assets will pay the highest premium to target stockholders, ensuring that target assets move to their highest valued use. *See* Bradley et al., *Synergistic Gains*, *supra* note 8, at 38; Gilson, *supra* note 1, at 62; *see also* Coffee, *supra* note 1, at 1280-81 (discussing the importance of maintaining a competitive auction market). *But cf.* Easterbrook & Fischel, *Auctions*, *supra* note 1, at 13-15 (arguing assets would move to their highest use even without auctions). *See supra* note 8 (discussing the theory that tender offers are wealth-creating transactions).

[30]Professors Gilson and Kraakman conclude that target directors do not always act in their shareholder's best interest:

> Both academic analysis and recent experience persuasively demonstrate that managers' efforts to defeat hostile bids often occur or persist despite the best interests of shareholders. Indeed, apart from the bidder itself, no one is less likely to be objective in appraising a hostile offer than the target's incumbent board of directors and its top managers.

Gilson & Kraakman, *supra* note 1, at 263 (footnote omitted); *see also, e.g.*, Oesterle, *supra* note 1, at 130-31 (arguing directors may act not only to keep their jobs, but to "reduce unsystematic risk" associated with managers' undiversified investment in the corporations they manage).

Target boards often seek to merge with a "white knight" — a bidder friendly to the target board — to avoid merging with a hostile bidder. *See* RALPH C. FERRARA ET AL., TAKEOVERS: ATTACK AND SURVIVAL — A STRATEGIST'S MANUAL 461-66 (1987) (describing reasons targets might prefer to merge with a white knight over a hostile bidder).

[31]The two benefits of stockholder choice discussed in the text compete with each other. Auctions facilitate competing bids, helping to ensure that target assets move to their highest valued use. They also increase the cost of acquisitions, deterring hostile offers and impeding their disciplinary function to some extent. However, these goals are not mutually exclusive. Tender offers are likely to achieve each goal to some extent, with legal principles setting a balance between them. *See* Bebchuk, *A Reply*, *supra* note 1, at 39-42 (arguing allocational benefits of auctions may outweigh the deterrent effect on bidders); Gilson, *supra* note 1, at 62-64 (concluding auctions facilitate target assets' movement to their highest use and may also enhance Easterbrook and Fischel's monitoring mechanism). *But see* Easterbrook & Fischel, *Auctions*, *supra* note 1, at 17-21 (rejecting Professor Gilson's argument that auctions can enhance monitoring).

broad discretion to manage corporate affairs.[32] However, courts have formulated the duty of loyalty which provides stockholders with a mechanism to hold accountable directors who use their position to appropriate corporate wealth to themselves through self-dealing, fraud, or other means.[33] Despite its focus on directors' actions, the purpose of the duty of loyalty is to align directors' incentives with their stockholders' interests.[34] Because stockholders' only interest in a sale of control is obtaining the highest available premium, courts should only allow target directors to enhance stockholders' ability to choose between alternatives.[35]

In conclusion, courts should allow stockholders to decide whether or not to accept a tender offer. Normally, directors are in the best position to make business decisions which enhance the stockholders' long-term value, and stockholders can police directors by alleging violations of the directors' fiduciary duties. Although directors are certainly capable of promoting stockholders' interests in the tender offer context, the fact that stockholders have no long-term interest in the target corporation, and the likelihood that

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[32]The policy reasons for the business judgment rule are that:

> corporate law should encourage, and afford broad protection to, informed business judgments (whether subsequent events prove the judgments right or wrong) in order to stimulate risk taking, innovation, and other creative entrepreneurial activities... . The special protection afforded business judgments is also based on a desire to limit litigation and judicial intrusiveness with respect to private-sector business decision[ ]making.

1 A.L.I. PRINCIPLES, *supra* note 14, § 4, introductory note at 135.

Because of the strong policy in favor of protecting directors' decisions, plaintiffs charging directors with abuse of discretion have the burden of proving a breach of fiduciary duty. *Aronson*, 473 A.2d at 812; *see also* 1 A.L.I. PRINCIPLES, *supra* note 14, § 4.01(d) (stating that a person challenging the conduct of a director has the burden of proving a breach of the duty of care). Courts review directors' decisions against a gross negligence standard. *Aronson*, 473 A.2d at 812.

[33]*See* Smith v. Van Gorkom, 488 A.2d 858, 872-73 (Del. 1985) (distinguishing directors' duty of loyalty from their duty to employ care in decision making under the business judgment rule). If stockholder plaintiffs can establish director interest, the burden shifts to the directors to show the "entire fairness" of the challenged transaction. Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983).

[34]*Cf.* Mitchell, *supra* note 15, at 597 n.92 ("Obviously the reason that the fiduciary principle exists is to protect the interests of the beneficiary.").

[35]The proposed focus on stockholder choice has some basis in Delaware case law. *See* Mills Acquisition Co. v. Macmillan, Inc. 559 A.2d 1261, 1288 (Del. 1988) (noting the Delaware Supreme Court's concern with ensuring fair auctions); AC Acquisitions Corp. v. Anderson, Clayton & Co., 519 A.2d 103, 116 (Del. Ch. 1986) (fashioning "an appropriate form of injunction . . . [intended] to remove the coercive aspects of the Company Transaction, but to permit that option to remain viable, so that if a majority of the Company's present shareholders prefer it, they will have a timely opportunity to elect that option").

target directors will be motivated to act in a self-interested way, combine to demonstrate that stockholders are more appropriate decision makers.[36]

B. *The Proper Role of Tender Offer Defenses*

Courts should allow target boards to employ only those tender offer defenses which enhance stockholders' ability to evaluate competing bids. For example, target directors may be able to fulfill their fiduciary duty to their stockholders in many cases simply by disclosing their beliefs about the relative merits of competing offers. Moreover, if target directors believe that a tender offer is coercive, courts should allow them to use a limited range of defenses which help their stockholders decide whether to accept the offer. Courts should also permit directors to offer stockholders alternatives to hostile bids such as repurchasing target shares to effectuate a management buyout[37] or encouraging additional bidders to enter an auction.[38] However, courts should not permit defenses which bar all bids. Directors can adequately protect stockholder interests without using preclusive defenses,[39] which are the defenses most likely to serve directors' interests at their stockholders' expense.

Because coercive bids frustrate the benefits of stockholder choice, courts should permit target directors to respond with a limited range of defenses.[40] Commentators have identified a number of potential sources of

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[36]Commentators critical of this view argue that target directors should not be forced to abandon their traditional ability to determine when a merger is appropriate simply because they are faced with a hostile tender offer. *See* Herzel et al., *supra* note 1, at 108-11; Lipton, *Takeover Bids*, *supra* note 1, at 113-20. *But see infra* notes 211-53 and accompanying text (proposing a rule whereby directors would be permitted to use a limited range of defensive tactics).

[37]In a management buyout, a corporation repurchases stock held by public stockholders. Directors and management may already have substantial stockholdings, and they may also acquire additional stock during such a transaction. The effect of a management buyout, or "going private" transaction, is to concentrate the target stock in the hands of the board and other "insiders," giving this group majority control. *See generally* FERRARA ET AL., *supra* note 30, at 74-79, 395-413 (summarizing self-tender offers). For a popular account of a failed stock repurchase involving RJR Nabisco, see BRYAN BURROUGH & JOHN HELYAR, BARBARIANS AT THE GATE: THE FALL OF RJR NABISCO (1990).

[38]Directors should not be allowed to use lockup agreements to bring in additional bidders, however. *See infra* notes 201-03 and accompanying text.

[39]For purposes of this article, a preclusive defense is one which denies stockholders the opportunity to consider a bid, generally by making the bid too expensive for the bidder.

[40]If bidders coerce stockholders, there is no assurance that another bidder would not have been willing to pay more in a competitive auction. As a result, target assets may not move to the bidder which can make the best use of them. Similarly, stockholders coerced into accepting a bid below the target's market value might replace an efficient management with a less efficient — if not more crafty — bidder.

stockholder coercion stemming from tender offers. The coercive elements of tender offers fall into two general categories. First, bidders may be able to induce target stockholders to tender into offers which the stockholders believe to be inadequate.[41] Second, bidders may succeed in capitalizing on informational advantages over target stockholders, allowing them to buy targets at bargain prices.[42]

Two-tiered tender offers provide the best illustration of the first form of stockholder coercion.[43] In a two-tiered offer, the bidding corporation tenders for a specified percentage of the target corporation's stock, often slightly more than fifty percent. If this "front-end" offer is successful, the bidder compensates target stockholders for their remaining shares in the takeover's "back-end." To induce stockholders to tender a controlling amount of stock in the front-end, the bidder often offers more consideration in the front-end than the back-end.[44] Professor Bebchuk explains that the difference between front-end and back-end values may persuade target stockholders to tender into offers which are not advantageous to them.[45] He

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[41]*See* Gilson & Kraakman, *supra* note 1, at 259 (discussing structural and substantive coercion).

[42]*See infra* notes 52-53 and accompanying text.

[43]Delaware courts have consistently stated that two-tiered offers are coercive. *See QVC*, 637 A.2d at 48 n.18; Gilbert v. El Paso Co., 575 A.2d 1131, 1135 n.7, 1145 (Del. 1990); *Unocal*, 493 A.2d at 956; *AC Acquisitions*, 519 A.2d at 113-14.

[44]Professors Bradley, Desai, and Kim argue that offers must be two-tiered to succeed. If the front-end value does not exceed stockholders' expectations of back-end value,

> target stockholders . . . will hold on to their shares because the payoff will be greater if they wait until others tender their shares and the value of the target is increased by the takeover. As a consequence, no one will tender, even though by tendering they would all realize a substantial capital gain. This result is nothing more than a manifestation of the free-rider problem. . . . Those who do not tender will hope to free ride on those who do, but because all target stockholders will feel this way, no shares will be tendered.

Bradley et al., *Synergistic Gains*, *supra* note 8, at 33. Professor Bebchuk lends some credence to this analysis by pointing out that a significant percentage of stockholders fail to tender even where bids offer substantial premiums. *See* Bebchuk, *Toward Undistorted Choice*, *supra* note 1, at 1733-35.

[45]Bebchuk, *Toward Undistorted Choice*, *supra* note 1, at 1708-35. Professor Bradford argues that the coercive nature of two-tiered offers stems from a situation similar to the classical "prisoner's dilemma." Bradford, *supra* note 24, at 421 (footnote omitted). For target stockholders to benefit from a tender offer, the blended value of the front-end and back-end offers must exceed the value which target shares would have had in the stockholders' hands absent the tender offer. *See id.* at 421-24. However, even if stockholders do not believe this condition holds, they may rationally choose to tender their shares if they believe the offer will succeed. As long as the front-end value is higher than the back-end value, stockholders who believe an offer will succeed will want to capture that higher value by tendering their shares. *See* Bebchuk, *Toward Undistorted Choice*, *supra* note 1, at 1723-26. *But see* Bradford, *supra* note 24, at 421 ("Although the theoretical basis of the pure coercion argument is sound, the

argues that even bids for all target shares may be coercive.[46]

Professor Bebchuk suggests a legislative solution to this form of stockholder coercion. Professor Bebchuk proposes that the current letter of transmittal (or "tender form") be restructured to allow the tenderer to indicate on the form whether he would like the bid to succeed or fail.[47] If stockholders holding a majority of the target stock oppose the bid, it will fail.[48] Furthermore, Professor Bebchuk suggests that the tender form should no longer provide the bidder with the unconditional right to purchase tenderer's shares.[49] Rather, the tenderer would mark on the form whether he permits the bidder to purchase his shares in the event the bidder fails to acquire a controlling interest.[50] This approach may eliminate stockholder coercion by isolating stockholders' decision to tender target shares from the stockholders' desire to see the bid succeed. Thus, a stockholder who votes against the bid can still receive a pro rata share of the proceeds if a majority approves the offer.[51]

Professors Gilson and Kraakman describe a second type of coercion which threatens target stockholders. Distinguishing the "structural coercion" described by Professor Bebchuk, these professors suggest that "substantive coercion" occurs when bidders take advantage of informational assymetries:[52]

> The only threat posed by a non-coercive offer that management considers unfair, ill-timed, or underpriced, is the threat that something will lead shareholders to accept it. But since such a threat is not *structurally* coercive, it will warrant a defensive response only if the offer is *substantively* coercive in that shareholders might somehow be led to accept unfavorable substantive terms voluntarily. Put another way, substantive coercion posits a likely mistake by target shareholders who

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argument is unsupported by fact.").

[46]Bebchuk, *Toward Undistorted Choice*, *supra* note 1, at 1714 & nn.57-58. *But see* Bradford, *supra* note 24, at 424-27.

[47]*See* Bebchuk, *Toward Undistorted Choice*, *supra* note 1, at 1748.

[48]*Id.*

[49]*Id.*

[50]*Id.*

[51]Bebchuk, *Toward Undistorted Choice*, *supra* note 1, at 1748-50. Federal regulations mandate that if a tender offer is oversubscribed the bidder must purchase shares from all tendering stockholders on a pro rata basis. 15 U.S.C. § 78n(d)(6) (1988); 17 C.F.R. §§ 240.14d-6(e)(vi), 240.14d-8 (1993); *see* 5 LOSS & SELIGMAN, *supra* note 4, at 2228-30. This rule prevents bidders from giving favored treatment to some target stockholders or from using additional coercive tactics such as buying shares on a "first come, first served basis." *Id.* at 2229 n.337.

[52]Gilson & Kraakman, *supra* note 1, at 259-60.

> would not accept the terms of an acquirer's offer if they knew what management knew about their own company, about the acquisitions market, or about management itself.[53]

Professors Gilson and Kraakman conclude that both structural coercion and substantive coercion justify preclusive defenses in some cases.[54] However, they argue that courts should apply a strict standard, requiring management to offer "serious justifications for defensive tactics."[55]

Courts should only sanction those nonpreclusive defensive tactics which allow stockholders to make a reasoned choice between competing bids or to induce additional bidders. First, courts should allow target boards to take reasonable steps to make their views about competing offers — including the implicit offer of maintaining the status quo — available to stockholders.[56] In addition, courts should permit two types of defensive tactics. First, courts should empower target boards to use necessary means to ensure that competing alternatives are presented to stockholders in a way that minimizes potential coercion.[57] Second, courts should allow target boards to present target stockholders with an alternative to hostile bids, either in the form of an alternative merger or of a management buyout.

First, target boards can mitigate the "threats"[58] posed by many hostile tender offers by simply providing information to their stockholders. For example, directors might solve substantive coercion by disclosing their reasons for believing that a pending offer is inadequate.[59] For instance, in

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[53] *Id.* at 259.

[54] *Id.* at 269.

[55] *Id.* at 271-73. They argue further that this test would facilitate corporate planning and induce target boards to limit themselves to defenses which promote stockholder interests. *Id.* at 272-73.

[56] Federal law currently requires target boards to issue a "reasoned" statement either recommending a pending offer, recommending against it, taking a neutral stance, or explaining why the board is unable to take a position within 10 days after the bidder initiates the offer. 17 C.F.R. § 240.14e-2(a) (1993). *See generally* 5 LOSS & SELIGMAN, *supra* note 4, at 2223-24 (summarizing disclosure procedures for target boards).

[57] At the same time, courts should restrict the permissible defenses to those which self-interested target directors are least likely to be able to use to their own advantage. *See infra* notes 224-53 and accompanying text.

[58] Delaware courts have required target directors to identify one or more threats posed by a hostile bid to justify defensive measures. *See infra* notes 84-87 and accompanying text.

[59] It is unlikely that hostile bidders will be able to use any nonpublic information about targets to enter into below market value purchases of control:

> [W]hy would a hostile bidder possess private information that the target's stock is undervalued? If this information exists, surely the target's management also has access to it. They could release it publicly or to another bidder and force the first bidder to pay a competitive price in an auction. . . . Hostile bidders are unlikely to have access to significant nonpublic information about targets.

one Delaware case, a hostile tender offer posed the following three threats:

> One concern was that Time shareholders might elect to tender into Paramount's cash offer in ignorance or a mistaken belief of the strategic benefit which a business combination with Warner might produce. Moreover, Time viewed the conditions attached to Paramount's offer as introducing a degree of uncertainty that skewed a comparative analysis. Further, the timing of Paramount's offer to follow issuance of Time's proxy notice was viewed as arguably designed to upset, if not confuse, the Time stockholders' vote.[60]

The target directors could have addressed the first and second concerns by disclosing their beliefs to stockholders. Instead, the target board refused to negotiate with the hostile tenderer (Paramount) and consummated a merger with another corporation (Warner).[61]

Because stockholders are the best decision makers in sales of control, the court should not have allowed the directors to impose their value judgments on stockholders.[62] At most, only the third concern justified the

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Bradford, *supra* note 24, at 435 (footnotes omitted). *But see* Gilson & Kraakman, *supra* note 1, at 262 ("Again, [target] management's claims may well be correct, even when management relies on wholly public information to value the firm; the securities market often appears to 'discount' the asset values of target firms.").

If target stockholders believe management claims about the "true value" of the firm, the target's stock price should rise. *See* Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1339 n.11 (Del. 1987) ("The [management p]lan called for the acceleration of exploration and production activities. . . . [T]here is support for a conclusion that . . . the [management p]lan and the resulting higher Newmont stock valuation, were not mere 'puffery'."). Stockholders will not tender to a bidder if they believe the target is worth more as an independent entity than the offer price; the target's stock price will rise above the offer price. *But cf.* Bebchuk, *Toward Undistorted Choice*, *supra* note 1, at 1727-28 (arguing this mechanism only functions smoothly if target stockholders are allowed to vote for or against a bid's success independent of their decision to tender).

[60]Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1153 (Del. 1990). *See infra* notes 100-18 and accompanying text (discussing the *Time* decision in detail).

[61]*Time*, 571 A.2d at 1154-55.

[62]Professors Gilson and Kraakman suggest that disclosure is not enough because target stockholders are likely to distrust target directors' assessment of competing bids. Gilson & Kraakman, *supra* note 1, at 262-64. This observation does not justify giving directors an opportunity to use preclusive defenses, though, because stockholders' distrust of target boards is animated by their recognition that the boards may be acting in a self-interested way. Stockholders must evaluate the information provided to them by target management, discounting it by the perceived likelihood that the target management is misrepresenting the facts. Material misrepresentations would be actionable, providing some protection to stockholders. *Cf.* Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1087 (1991) (stating that a board's material misrepresentations to stockholders whose votes are required for a merger

board's use of a defensive mechanism to force the hostile bidder to delay consummation of its offer for a brief time during which stockholders could have resolved any confusion.[63]

Another case demonstrates that substantive coercion can pose real concerns which disclosure does not easily solve. The Court of Chancery of Delaware permitted a target board to use preclusive defenses, justifying its decision, in part, on the fact that the target was expecting a large settlement from a law suit it had filed.[64] Disclosure is problematic in such a situation because it might work to decrease the target's value to its stockholders. However, the court's decision to allow target defenses until the litigation was settled is also problematic because timing is often critical for tender offers.[65] Moreover, the risk posed by a potentially inadequate bid on the unusual facts of this case is insufficient to justify a general rule permitting preclusive defenses.[66] The target directors should have apprised their stockholders of the damages they sought and possibly other information, such as the outcome of similar litigations. Additionally, the target directors could have made nonpublic information available to potential bidders to encourage bids reflecting that information[67] or offered a management buyout. Ultimately, however, the decision to accept or reject the hostile bid should remain with the stockholders to avoid directors acting in a self-interested manner.[68]

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are actionable although liability was inappropriate on the facts of the case).

[63]Part IV(A) proposes a rule which is designed to give target stockholders an opportunity to make a reasoned choice under these circumstances. *See infra* notes 183-84 and accompanying text.

[64]Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 278 (Del. Ch. 1989). In *Shamrock*, the court stated:

> Polaroid is about to begin trial of the damages portion of its patent infringement litigation against Kodak. . . . Even a recovery of "only" $1.2 billion [of the $5.7 billion sought by Polaroid] or $9.46 per share constitutes more than 20% of Polaroid's present market value.
>
> . . . [I]f defendants' assessments of the value of the Kodak litigation were disclosed, Polaroid's bargaining position with Kodak could be seriously weakened.
>
> . . . In the foreseeable future, the amount of the damage award will be quantified if not paid. Until that time, it seems appropriate to consider a non-coercive but inadequate tender offer to be a threat.

Id. at 289-90.

[65]*See* RONALD J. GILSON, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 695-96 (1986) (noting delay increases the financing cost of hostile offers and may result in bidders losing interest in a target).

[66]This is especially true in light of empirical evidence demonstrating that very few, if any, bids offer stockholders less than the target's market value as consideration. *See* Bradford, *supra* note 24, at 425-27.

[67]*See infra* notes 197-98 and accompanying text.

[68]This result may be fairly harsh on the facts of *Shamrock*, although it is not clear that the hostile bid was truly undervalued. Additionally, if courts give directors the discretion to use

Courts should also permit target boards to take steps to ensure fair auctions which promote stockholder choice.[69] As already discussed, Professor Bebchuk suggests legislative reform providing stockholders the opportunity to vote for or against a bid's success independent of their decision whether or not to tender.[70] However, where state legislatures have not adopted such provisions, there is no reason why courts should not allow target boards to afford stockholders this choice on their own initiative.[71] Furthermore, target boards may have an incentive to adopt such an approach if they are barred from using preclusive tactics. This device might also serve to keep directors in office. On the other hand, preclusive defenses prevent not only coercive bids but also bids which are in stockholders' interest and ensure target boards' ability to remain in office.

Finally, courts should allow target directors to provide stockholders with alternatives to hostile bids. Directors may induce additional bidders to enter an auction, for example.[72] Similarly, target directors may offer to repurchase stock from target stockholders; such repurchases often take the form of a management buyout.[73] This alternative provides target directors an opportunity to convince lenders, as opposed to stockholders, that they can make the target worth more than the hostile bid. If the creditors agree and finance a management buyout, stockholders will benefit by receiving the increased premium for their stock.[74] Courts should require directors offering

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preclusive defenses because a potential for substantive coercion exists, directors will likely find ways to demonstrate some form of coercion in most, if not all, hostile bids. *But see* Gilson & Kraakman, *supra* note 1, at 267-68 (arguing courts can effectively evaluate directors' substantive coercion claims).

[69]*Cf.* CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69 (1987) (holding Indiana's "control share acquisitions" statute — which grants to target stockholders the ability to vote whether or not they wish a hostile offer to succeed regardless of their desire to tender if it does succeed — constitutional); *see infra* notes 185-92 and accompanying text.

[70]*See supra* notes 47-51 and accompanying text.

[71]*See infra* notes 190-92 and accompanying text.

[72]*See infra* notes 197-203 and accompanying text.

[73]*See* Bradley et al., *Synergistic Gains*, *supra* note 8, at 36-38 (arguing that management buyouts provide a market check against hostile bids below market value); *cf.* Gilson & Kraakman, *supra* note 1, at 256-57 ("[A] broad reading of *Anderson, Clayton* leads to a kind of safe harbor for hostile acquirers: In response to a hostile bid that is *not* coercive on its face, management can do no more than offer a genuine alternative.").

[74]Management bids in a competitive auction are consistent with both goals of stockholder choice. If the incumbent management can offer stockholders the most consideration for target stock, they are likely able to make the most efficient use of target assets. This circumstance further indicates that the incumbent directors should retain their positions.

Professor Coffee argues target directors might take advantage of inside information to enter into a management buyout transaction below the target's market value. Coffee, *supra* note 1, at 1196-98. This concern is valid, but if the target is outbidding a hostile bidder, target stockholders necessarily benefit. Similarly, the concern that management buyouts may be two-

a management buyout to demonstrate that the target's offer enhances stockholder choice. For instance, directors might be required to demonstrate that the target offer is not timed to conclude prior to the hostile bid, a situation which might coerce target stockholders to tender into the management buyout.

In conclusion, courts should limit target directors' responses to hostile tender offers to defenses which unambiguously enhance stockholder choice. The proposed approach strikes a balance between target directors' duty to protect their stockholders and the potential that the directors will act in a self-interested way.[75] By encouraging the use of disclosure and the permissible defenses discussed in this section, courts provide target directors with incentives to focus either on offering stockholders alternatives worth more than any hostile bid or to demonstrate that the target is worth more than any other bid. This approach focuses not on directors' actions per se, but on maximizing stockholder wealth. Furthermore, it reflects that change of control creates a unique situation in which stockholders' long-term and short-term interests are identical. This circumstance makes directors' normal role as proxy decision makers for their stockholders unnecessary.

III. DELAWARE'S HEIGHTENED SCRUTINY OF TARGET DIRECTORS' ACTIONS

Delaware courts apply a heightened scrutiny to target directors' tender offer defenses. This review, like the defenses, has become more sophisticated over time. Part II(A) describes the evolution of Delaware's review of tender offer defenses. Part II(B) describes the Delaware Supreme Court's recent decision in *Paramount Communications, Inc. v. QVC Network, Inc.*,[76] arguing that this decision demonstrates the court's trend toward even stricter scrutiny of target defenses.

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tiered or otherwise coercive, *see* Gilson & Kraakman, *supra* note 1, at 255 n.32, is unlikely to create a problem so long as the two alternatives are posed in a way that allows target stockholders to make a reasoned choice. Once an auction begins, it is almost certain that target stockholders will receive a premium. *See* Bradford, *supra* note 24, at 451-55.

[75]Allowing target directors to use choice enhancing tactics avoids the undesirable outcome of deterring target directors from trying to protect stockholder interests. There is every reason to believe that some target boards truly act out of a desire to promote stockholder interests rather than to entrench themselves. *Cf.* 1 A.L.I. PRINCIPLES, *supra* note 14, § 6.02, cmt. a, at 407-08, cmt. c, at 411 (arguing a pure duty of loyalty approach to target defenses is inappropriate because it is incapable of distinguishing between cases of director self-interest and cases where directors legitimately act on behalf of stockholders). *But see* Seligman, *supra* note 1, at 10-22 (advocating duty of loyalty analysis of tender offer defenses); Easterbrook & Fischel, *Proper Role*, *supra* note 1, at 1198-99 (arguing directors should remain passive in response to tender offers).

[76]637 A.2d 34 (Del. 1993).

A. *History*

The Delaware Supreme Court quickly realized that courts must apply a heightened level of scrutiny to directors' actions[77] in change of control situations.[78] In two opinions, *Bennett v. Propp*[79] and *Cheff v. Mathes*,[80] the court recognized that directors are faced with a conflict of interest in change of control situations.[81] The Delaware court determined that the business judgment rule had to be modified to evaluate directors' actions in change of control situations to account for this potential conflict.[82] In *Bennett*, the court declared the rule that directors defending against a change of control have the burden of demonstrating that their action is "primarily in the corporate interest."[83] To make this showing, the court requires directors to demonstrate that any defenses are in response to a "threat" to the target corporation.[84]

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[77]Delaware courts ordinarily review directors decisions against a gross negligence standard under the business judgment rule. *Aronson*, 473 A.2d at 812; *see supra* notes 14 & 32.

[78]For purposes of this article, a change of control occurs whenever a controlling block of a corporation's stock changes hands as the result of an intentional act. A successful tender offer for a controlling percentage of target stock necessarily involves a change of control under this view. *See infra* note 163 and accompanying text. *But see QVC*, 637 A.2d at 42-43 (restricting the definition of change of control to situations where a controlling block of target stock comes to rest in the hands of a single person or group).

[79]187 A.2d 405 (Del. 1962).

[80]199 A.2d 548 (Del. 1964).

[81]*See id.* at 554; *Bennett*, 187 A.2d at 409.

[82]*Cheff*, 199 A.2d at 554; *Bennett*, 187 A.2d at 409.

[83]*Bennett*, 187 A.2d at 409. This rule stands in contrast to the business judgment rule which places the burden of demonstrating a breach on the plaintiff. *See supra* note 32. *Cheff* made clear, however, that absent a "personal and pecuniary interest" target directors are not required to demonstrate the entire fairness of the transaction. *See Cheff*, 199 A.2d at 554-55; *see also* 1 A.L.I. PRINCIPLES, *supra* note 14, § 6.02, cmt. a, at 407-09 (supporting the Delaware courts' view that directors' fees and other standard prerogatives are not sufficient to give rise to a duty of loyalty analysis). *But see* Easterbrook & Fischel, *Proper Role*, *supra* note 1, at 1198-99 (suggesting that actions taken by target boards to resist takeover bids should not even be subject to the justification that the action benefits the target; rather, such actions should be "proscribed completely"); Seligman, *supra* note 1, at 10-22 (arguing a duty of loyalty analysis is appropriate).

[84]*Bennett*, 187 A.2d at 408-10 (holding that the challenged share repurchase was intended to entrench the target's directors); *Cheff*, 199 A.2d at 556 (allowing a share repurchase because "the board of directors . . . believed, with justification, that there was a reasonable threat to the continued existence of Holland, or at least existence in its present form"); *see also* Condec Corp. v. Lunkenheimer Co., 230 A.2d 769, 776-77 (Del. Ch. 1967) (cancelling target directors' issuance of new shares to dilute a successful bidder's equity interest because the defendant directors could not demonstrate a justifiable belief in a threat).

The Delaware court elaborated on the "threat" requirement in *Unocal Corp. v. Mesa Petroleum Co.*[85] Citing *Cheff* and *Bennett*, the court noted that target boards' defensive actions raise an "omnipresent specter that a board may be acting primarily in its own interests," requiring courts to place an "enhanced duty" on directors to justify such defenses.[86] The court adopted the previous decisions' "threat requirement" and added a proportionality element: "If a defensive measure is to come within the ambit of the business judgment rule, it must be reasonable in relation to the threat posed."[87]

Only one year after the *Unocal* decision, the Delaware Supreme Court adopted a much harder line against tender offer defenses. In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[88] the court enjoined Revlon from using certain defensive tactics which favored its white knight over a hostile tender offer.[89] The Delaware Supreme Court affirmed the court of chancery decision enjoining a lockup option, a no shop agreement, and a termination fee. The court reasoned:

> [W]hen Pantry Pride increased its offer to $50 per share, and then to $53, it became apparent to all that the break-up of the company was inevitable. The Revlon board's authorization permitting management to negotiate a merger or buyout with a third party was a recognition that the company was for sale.

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[85]493 A.2d 946 (Del. 1985).

[86]*Id.* at 954.

[87]*Id.* at 955. The court in *Unocal* ruled that the directors' actions satisfied the proportionality test. *Id.* at 956. In that case, *Unocal*, the target, offered to repurchase stock from stockholders other than Mesa, the bidder, if Mesa's hostile front-end bid was successful. Unocal hoped its defense would deter Mesa from consummating the hostile offer. *Id.* Alternatively, if Mesa were to succeed, Unocal stockholders whose shares were not purchased in the "front-end" of Mesa's offer would be assured a fair price in the "back-end." *Id.* The court reasoned that if Mesa were allowed to tender to Unocal, each of these purposes would be frustrated. *Id.* "First, if Mesa could tender its shares, Unocal would effectively be subsidizing the former's continuing effort to buy Unocal stock at $54 per share. Second, Mesa could not, by definition, fit within the class of shareholders being protected from its own coercive and inadequate tender offer." *Id.*

The American Law Institute advocates a statutory formulation which closely parallels *Unocal*, but places the burden of proof on the plaintiff challenging the defense. 1 A.L.I. PRINCIPLES, *supra* note 14, § 6.02, cmt. a, at 408.

Beyond a general consensus that two-tiered offers pose a threat, see *supra* note 43, Delaware courts have struggled to determine both what constitutes a threat and how to evaluate whether or not a defense is proportionate to any threats identified by a target board. *See generally* Gilson & Kraakman, *supra* note 1, at 252-60, 266-73 (arguing that *Unocal*'s proportionality test, if properly interpreted, provides an effective mechanism for evaluating takeover defenses).

[88]506 A.2d 173 (Del. 1986).

[89]*Id.* at 185.

> The duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit.[90]

The nature of directors' "*Revlon* duty" to maximize value for stockholders has been a source of much consternation for Delaware courts,[91] as has the question of what specific event triggers this duty.[92]

The Delaware court directly addressed what constitutes a sale sufficient to trigger *Revlon*'s duty to maximize stockholder value in *Ivanhoe Partners v. Newmont Mining Corp.*[93] In *Ivanhoe*, the target's defenses resulted in a white knight holding a controlling block of approximately forty-nine percent of target stock.[94] Nevertheless, the court found that the target board did not have a duty to sell the company to the highest bidder.[95] The

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[90]*Id.* at 182.

[91]The Delaware Supreme Court has rejected the view that *Revlon* requires an auction in every sale of corporate control. *See* Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989); *see also* TW Servs., Inc. v. SWT Acquisition Corp., [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,334, at 92,179 (Del. Ch. 1989), *reprinted in* 14 DEL. J. CORP. L. 1169, 1184-85 (1989) (holding that the "*Revlon* duty" is not necessarily a duty to conduct an auction, but it is the duty "to exercise judgment (in good faith and prudently) in an effort to maximize [shareholders'] immediate . . . value"); Barry Reder, *The Obligation of a Director of a Delaware Corporation to Act as an Auctioneer*, 44 BUS. LAW. 275, 279 (1989) (observing that the "*Revlon* duty" "has been misinterpreted to require an auction or equivalent whenever a company is to be sold or there is to be a change in control"); *cf.* 1 A.L.I. PRINCIPLES, *supra* note 14, § 6.01, cmt. a(2)(e)(i), at 395 (observing that directors are not generally required to initiate a formal auction to fulfill their obligation to obtain fair value); *id.* § 6.02, cmt. a, at 409 (explaining that § 6.02 does not place a duty to conduct an auction on directors who are responding to an unsolicited tender offer). Rather, Delaware courts have stated that *Revlon* requires target boards to conduct some form of "market check" to determine if better offers are available. *E.g.*, *Barkan*, 567 A.2d at 1287; *TW Servs.*, [1989 Transfer Binder] Fed. Sec. L. Rep. at 92,179 n.8, *reprinted in* 14 DEL. J. CORP. L. at 1184 n.8. Delaware courts have failed to explain what sort of market check could ensure the highest available price for target stockholders.

[92]In Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1989), the court restated that a sale is the triggering event. *Id.* at 1284-85 (quoting *Revlon*, 506 A.2d at 182); *see also TW Servs.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) at 92,179-92,180, *reprinted in* 14 DEL. J. CORP. L. at 1185 (ratifying *Mills Acquisition* by determining that the duty arises upon the board's decision to sell). What constitutes a sale, however, is not clear. *See Mills Acquisition*, 559 A.2d at 1285 n.35. Broad statements that any change of control triggers *Revlon* duties, see *id.* at 1288; *Barkan*, 567 A.2d at 1286, are not helpful, as the definition of "change of control" is no more evident than the definition of "sale." *See infra* notes 159-65 and accompanying text (discussing current interpretation of the terms "sale" and "change of control").

[93]535 A.2d 1334 (Del. 1987).

[94]*Id.* at 1345.

[95]*Id.*

court posited that this duty arises only if a sale is inevitable.[96] The court held this condition was not satisfied in *Ivanhoe* for two reasons: (1) the target board never intended to sell the target, and (2) there was no actual bidding contest or sale.[97] The *Ivanhoe* court adopted a subjective definition of "sale"[98] which indicates a retreat from *Revlon*'s emphasis on maximizing stockholder value.[99]

The Delaware Supreme Court moved even further from *Revlon*'s emphasis on maximizing stockholder value in *Paramount Communications, Inc. v. Time Inc.*[100] *Time*, like *Ivanhoe*, relied largely on the target directors' subjective intent to justify its finding that no sale had occurred to trigger a duty to maximize stockholder value. The court permitted target defenses in *Time*, accepting the target board's justification that a merger with Warner Communications, Inc. was more in keeping with Time's long-term business plan than a merger with Paramount, the hostile bidder.[101]

Paramount's hostile tender offer came in the middle of a proposed merger between Time and Warner.[102] To further its plan to expand into the entertainment industry on a global scale, Time considered several merger partners, including Warner.[103] Extensive negotiations ensued between Time and Warner and on March 3, 1989, Time's board voted to approve a stock

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[96]*Id.*

[97]*Ivanhoe Partners*, 535 A.2d at 1345. The court reasoned that although Gold Fields, the white knight, held one-third of the target stock prior to Ivanhoe Partners' hostile bid, Gold Fields was not a bidder because:

> Gold Fields . . . wished only to protect its already substantial interest in the company. . . . Thus, the Newmont board did not "sell" the company to Gold Fields. The latter's purchases were from private sellers. While Gold Fields now owns 49.7% of the stock, its representation on the board is only 40% because of the restrictions of [a] standstill agreement. These facts do not strip the Newmont board of the presumptions of independence and good faith under the business judgment rule.

Id. (citation omitted).

[98]The court stated, "Newmont was never for sale. During the short period in which these events occurred, the Newmont board held fast to its decision to keep the company independent." *Id.*

[99]*See* Seligman, *supra* note 1, at 20 (characterizing *Ivanhoe* as a "sting[y]" reading of *Revlon*). This article advocates a broad definition of "sale" in the change of control context consonant with an emphasis on stockholder choice. *See infra* note 262.

[100]571 A.2d 1140 (Del. 1990).

[101]*Id.* at 1154 ("Directors 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.").

[102]*Id.* at 1146-47.

[103]*Id.* at 1144.

for stock merger with Warner.[104] The Time board adopted several defenses intended to ensure the success of the Time-Warner merger.[105] Then, Paramount made a hostile, all cash offer for all outstanding Time stock, conditioned on Time abandoning its plans to merge with Warner.[106] Time rejected this offer and recast its merger with Warner as an acquisition by Time of Warner for a mixture of cash and securities.[107] In response, Paramount raised its bid, but Time again rejected Paramount's overtures.[108] Paramount finally sued to enjoin Time from completing its tender offer with Warner.[109]

The Delaware Supreme Court held that the Time board was not required to maximize the short-term value of Time stock.[110] The court distinguished the case from *Revlon* by arguing that Time had not put itself up for sale, despite the fact that Warner stockholders ended up with sixty-two percent of Time stock.[111] The court reasoned that the duty to maximize stockholder value occurs in either of two situations:

> The first, and clearer one, is when a corporation initiates an active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company. However, *Revlon* duties may also be triggered where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction involving the breakup of the company.[112]

The court concluded that Time's recasting of its merger agreement with Warner was no basis to conclude that Time had abandoned its strategic plan or made a sale of Time inevitable.[113]

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[104]*Time*, 571 A.2d at 1146. For an exhaustive, if not sensationalized, account of the circumstances leading up to the Time-Warner merger, see RICHARD M. CLURMAN, TO THE END OF TIME: THE SEDUCTION AND CONQUEST OF A MEDIA EMPIRE (1993).

[105]*See Time*, 571 A.2d at 1146-47.

[106]*Id.* at 1147.

[107]*Id.* at 1148.

[108]*Id.* at 1149.

[109]*Time*, 571 A.2d at 1149.

[110]*Id.* at 1154.

[111]*Id.* at 1146, 1149-51.

[112]*Id.* at 1150 (citation and footnote omitted). The court did not exclude the possibility that other circumstances would trigger *Revlon*. *Id.* ("[T]here are, generally speaking and without excluding other possibilities, two circumstances which may implicate *Revlon* duties.").

[113]*Time*, 571 A.2d at 1151.

The court next addressed whether Time's defenses satisfied *Unocal*'s proportionality test.[114] The court rejected Paramount's argument that its offer did not pose a threat to Time because a *Unocal* threat arises only in the case of a coercive two-tiered bid or a bid below the target's market value.[115] The court again rejected *Revlon*'s emphasis on maximizing short-term stockholder value by refusing to evaluate the long-term versus short-term investment goal for shareholders. The court reasoned that such an analysis would distort the *Unocal* process.[116] The court concluded that Time's board had reasonably perceived three threats stemming from Paramount's offer and that the boards' actions were proportionate to those threats, satisfying *Unocal*'s second prong.[117]

By deferring to target directors' determination that a hostile bid was unacceptable because it would frustrate their long-term business plans, the court in *Time* raised questions as to the vitality of directors' duty to maximize stockholder value in a sale.[118] The Delaware Supreme Court apparently reversed its trend toward stricter scrutiny of target defenses illustrated in *Unocal* and *Revlon*. However, a recent opinion indicates that the court is again moving to limit target defenses and has renewed its emphasis on target directors' duty to maximize stockholder value.

B. Paramount Communications, Inc. v. QVC Network, Inc.

The Delaware Supreme Court recently revisited its analysis of tender offer defenses in *Paramount Communications, Inc. v. QVC Network, Inc.*[119] The court read *Revlon* more broadly in *QVC* than it had in *Time*, concluding that Paramount's board had breached a duty to maximize stockholder value.[120] Nevertheless, the court's holding was limited to the facts of the case and depended heavily on a restrictive definition of "sale of control."[121]

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[114] *Id.* at 1151-55. *See supra* notes 85-87 and accompanying text.

[115] *Time*, 571 A.2d at 1152-53.

[116] *Id.* at 1153. The court demonstrates a belief that the business judgment rule's policy to leave business planning in the hands of directors outweighs *Unocal*'s concern with the "omnipresent specter" of director self-interest in change of control transactions. *See* Gregory P. Williams, *The* Time-Warner *Decision: Further Guidance, But Questions Remain*, INSIGHTS, June 1990, at 29, 31 (questioning *Time*'s apparent abrogation of *Unocal*'s approach).

[117] *Time*, 571 A.2d at 1153-55.

[118] *See, e.g.*, Seligman, *supra* note 1, at 21 ("[*Time*], in effect, reduces *Revlon* to a matter of form."); Williams, *supra* note 116, at 30-31.

[119] 637 A.2d 34 (Del. 1993).

[120] *Id.* at 51.

[121] *See id.*; *see also infra* notes 159-62 and accompanying text (discussing the court's interpretation of change of control).

In the late 1980s, Paramount began searching for a strategic partner.[122] Paramount initially considered Viacom as a merger partner in 1990, but discussions were limited largely because Viacom's and Paramount's CEOs were unable to come to terms regarding who would run the surviving entity.[123] Davis and Redstone began meeting again in April of 1993.[124] While governance of a combined Paramount-Viacom continued to be an obstacle, the two corporations started to negotiate seriously in September[125] when Davis notified the Paramount board that negotiations were going forward and presented them with information provided by Paramount's investment bank, Lazard Freres & Co.[126]

The Paramount board unanimously approved a merger agreement with Viacom which included three significant defensive measures designed to thwart the success of any potential competing bid.[127] First, Paramount agreed to be bound by a no shop agreement which prevented it from considering alternate deals unless specified conditions were met.[128] Second, Paramount agreed to pay to Viacom a $100 million termination fee if the Paramount-Viacom merger did not succeed.[129] Third, the merger agreement included a "Stock Option Agreement" under which Paramount granted to Viacom the right to purchase almost twenty percent of Paramount's outstanding stock at the, then current, market price if the merger failed.[130] The court emphasized

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[122]*QVC*, 637 A.2d at 38. Paramount believed that a partner was necessary to remain competitively viable in "the rapidly evolving field of entertainment and communications." *Id.*

[123]QVC Network, Inc. v. Paramount Communications, Inc., 635 A.2d 1245, 1248 (Del. Ch.), *aff'd*, 637 A.2d 34 (Del. 1993). Paramount's chairman and CEO, Martin Davis, held the same positions during Paramount's failed attempt to acquire Time. *See Time*, 571 A.2d at 1147. Viacom's chief executive officer, Sumner Redstone, is also the chairman and majority stockholder.

[124]*QVC*, 637 A.2d at 38.

[125]*Id.* at 39.

[126]*Id.*

[127]*Id.* Paramount also agreed to amend its charter to exempt the proposed deal with Viacom from its poison pill. *Id.*

[128]*QVC*, 637 A.2d at 39. The two conditions were:

> Paramount would not solicit, encourage, discuss, negotiate, or endorse any competing transaction unless: (a) a third party "makes an unsolicited written, bona fide proposal, which is not subject to any material contingencies relating to financing"; and (b) the Paramount Board determines that discussions or negotiations with the third party are necessary for the Paramount Board to comply with its fiduciary duties.

Id.

[129]*Id.*

[130]*Id.* The court treated this as a lockup. *Id.* at 51. Delaware courts have allowed lockups which entice new bidders into auctions, but not those which end auctions. *Revlon*, 506 A.2d at 183; *see also* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1284 (Del. 1989) ("Although we have held that such agreements are not *per se* illegal, we recognized that

the unusual nature of two terms of the stock option: (1) the agreement allowed Viacom to pay for the stock with subordinated debt securities rather than cash, and (2) Viacom could exercise the option as a "put," requiring Paramount to pay to Viacom "the difference between the purchase price and the market price of Paramount's stock."[131] Paramount and Viacom publicly announced the proposed merger, describing it as a "done" deal.[132]

QVC entered the picture only days after Paramount and Viacom announced their merger agreement.[133] Despite the fact that Davis informed Barry Diller, QVC's CEO, that Paramount was not for sale,[134] Diller informed Davis by letter that QVC was willing to offer $80 per share in cash and securities for Paramount stock.[135] The Paramount board refused to consider QVC's offer until QVC could provide evidence of financing, relying on Paramount's no shop agreement with Viacom.[136] QVC did provide satisfactory evidence of financing, but negotiations moved slowly.[137] QVC, dissatisfied with the progress of negotiations with Paramount, sued to enjoin Paramount from honoring the defensive aspects of the Paramount-Viacom merger agreement.[138] QVC also announced that it was initiating an all cash offer for fifty-one percent of Paramount's outstanding stock at $80 per share.[139]

Paramount and Viacom responded to QVC's offer by amending the merger agreement to recast their merger as an all out tender offer by Viacom for Paramount.[140] In the new agreement, Viacom offered $80 per Paramount share in cash.[141] Otherwise the court found the amended merger agreement to be "essentially the same as the Original Merger Agreement."[142] The court emphasized that the Paramount board failed to use the leverage QVC's

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like measures often foreclose further bidding to the detriment of shareholders, and end active auctions prematurely.").

[131] *QVC*, 637 A.2d at 39.

[132] *Id.* "Redstone described [the deal] as a 'marriage' that would 'never be torn asunder' and stated that only a 'nuclear attack' could break the deal." *Id.*

[133] *Id.*

[134] *Id. at 38.*

[135] *QVC*, 637 A.2d at 39.

[136] *Id.* at 40.

[137] *Id.*

[138] *Id.*

[139] *QVC*, 637 A.2d at 40.

[140] *Id.*

[141] *Id.*

[142] *Id.* The amended agreement did provide that Paramount could retain its poison pill defense against Viacom if required by its fiduciary duties or terminate its agreement with Viacom if Paramount decided to recommend an alternate transaction. *Id.*

competing offer afforded it to remove or modify any of the defensive measures in the original merger agreement.[143]

Viacom commenced its offer for Paramount shares on October 25 and QVC commenced its offer two days later.[144] A bidding war ensued with Viacom raising its front-end offer to $85 per share and QVC responding with a $90 per share offer.[145] Paramount's board met and decided to recommend Viacom's bid to its stockholders.[146] The board concluded that because QVC's bid was conditional, it was not in the best interests of the stockholders and that the Viacom offer "would be more advantageous to Paramount's future business prospects than a QVC transaction."[147]

The Court of Chancery of Delaware granted QVC a preliminary injunction preventing Paramount from modifying its poison pill in favor of Viacom and barring Viacom from consummating its tender offer.[148] The court also enjoined Paramount and Viacom from exercising the stock option agreement.[149] The court refused, however, to enjoin Viacom from exercising its right to a termination fee under the amended merger agreement.[150] Paramount, Viacom, and the individual defendants in the suit below appealed the chancellor's decision.[151]

Affirming the court of chancery, the Delaware Supreme Court directly addressed what conditions trigger target directors' duty to maximize stockholder value.[152] The court concluded that Paramount's directors had assumed this duty and breached it.[153] The court rejected Paramount's argument that a corporate breakup is a necessary precondition to application of the duty to maximize stockholder value.[154] The court stated that the directors' obligation to seek the best value for stockholders attaches when a corporate transaction "will cause: (a) a change in corporate control; or (b) a break-up of the corporate entity."[155] The court ruled that Paramount's

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[143]*QVC*, 637 A.2d at 40-41.

[144]*Id.* at 41.

[145]*Id.*

[146]*Id.*

[147]*QVC*, 637 A.2d at 41 (footnote omitted).

[148]*QVC*, 635 A.2d at 1270.

[149]*Id.* at 1272.

[150]*Id.* at 1270-71.

[151]*QVC*, 637 A.2d at 36.

[152]*Id.* at 48-50.

[153]*Id.*

[154]*Id.* at 47-48. *But see Time*, 571 A.2d at 1150 ("[W]e premise our rejection of plaintiffs' *Revlon* claim on . . . the absence of any substantial evidence to conclude that Time's board, in negotiating with Warner, made the dissolution or break-up of the corporate entity inevitable . . . .").

[155]*QVC*, 637 A.2d at 48.

merger with Viacom constituted a sale of control,[156] obligating Paramount's board to maximize value for its stockholders.

Although *QVC* did not overrule *Time*, the court did adopt a broader reading of directors' duty to maximize stockholder value. *QVC* did not adopt the subjective definition of "sale"[157] used in *Time*; instead, the court reasoned that directors' intent to auction off the corporation is not a prerequisite to courts imposing this duty on target boards:

> The Paramount defendants have misread the holding of *Time-Warner*. . . . [T]he instant case is clearly within the first general scenario set forth in [that case]. The Paramount Board, albeit unintentionally, had "initiate[d] an active bidding process seeking to sell itself" by agreeing to sell control of the corporation to Viacom in circumstances where another potential acquiror (QVC) was equally interested in being a bidder.[158]

This language suggests that in the future the Delaware Supreme Court may be less responsive to target boards' claims that defenses are justified because the board did not intend to sell the target.

The court in *QVC* distinguished its decision in *Time* by arguing that no sale of control occurred in *Time*. The court implied that a change of control only occurs where a transaction leads to majority ownership of the target's stock being "vested in a single person, entity, or group."[159] The court observed that majority stockholders pose a number of threats to minority stockholders.[160] Since Viacom's majority stockholder[161] would

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[156]*Id.* The court explicitly stated that the phrases "sale of control" and "change of control" have identical meanings for doctrinal purposes. *Id.* at 42 n.10.

[157]*See supra* notes 96-99, 101, 111-13 and accompanying text.

[158]*QVC*, 637 A.2d at 47. *QVC*'s analysis here is consistent with the Delaware Supreme Court's prior statement in Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1988):

> Notably, in *Revlon* we held that when several suitors are actively bidding for control of a corporation, the directors may not use defensive tactics that destroy the auction process. When it becomes clear that the auction will result in a change of corporate control, the board must act in a neutral manner to encourage the highest possible price for shareholders.

Id. (citations omitted).

[159]*QVC*, 637 A.2d at 43.

[160]*Id.* The court noted that majority stockholders are authorized by statute to take various actions significantly affecting the corporation, including the right to:

> (a) elect directors; (b) cause a break-up of the corporation; (c) merge it with another company; (d) cash-out the public stockholders; (e) amend the certificate of incorporation; (f) sell all or substantially all of the corporate assets; or (g) otherwise alter materially the nature of the corporation and the public stockholders' interests.

Id.

become the majority stockholder of the surviving entity of a Paramount-Viacom merger, the court reasoned that this situation justified imposing the duty to maximize stockholder value on Paramount's board.[162]

The court's limited definition of "change of control" poses a number of difficulties. First, *QVC*'s definition appears to limit the holdings of prior cases which use the change of control terminology.[163] Additionally, *QVC* creates a new justification for defensive tactics.[164] Target boards are likely

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[161]"Sumner M. Redstone . . . owns indirectly approximately 85.2 percent of Viacom's voting Class A stock and approximately 69.2 percent of Viacom's nonvoting Class B stock through . . . an entity 91.7 percent owned by Redstone." *Id.* at 38.

[162]*Id.* at 43. The court pointed out that the Paramount-Viacom merger had considerable economic consequences for the shareholders:

> Once control has shifted, the current Paramount stockholders will have no leverage in the future to demand another control premium. As a result, the Paramount stockholders are entitled to receive, and should receive, a control premium and/or protective devices of significant value. There being no such protective provisions in the Viacom-Paramount transaction, the Paramount directors had an obligation to take the maximum advantage of the current opportunity to realize for the stockholders the best value reasonably available.

Id. The court observed that in *Time* the target's stock ended up as it began — in the hands of "the fluid aggregation of unaffiliated stockholders." *Id.*

[163]The court cited two decisions, Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1288 (Del. 1989), and Barkan v. Amsted Indus., Inc. 567 A.2d 1279, 1286 (Del. 1988), for the proposition that *Revlon* applies in all change of control circumstances. *See QVC*, 637 A.2d at 46. Neither of these cases limits its discussion of changes of control to circumstances where a single stockholder or group will obtain majority control of a target. In *Mills Acquisition*, for instance, Robert Maxwell would have individually controlled the target if his offer succeeded. The court did not mention any threat posed by Maxwell's potential control of Macmillan, but concluded that "continu[ed] hostility toward Maxwell cannot be justified." *Mills Acquisition*, 559 A.2d at 1282. Similarly, *Barkan* treated a change of control as a normal incident of an auction. *Barkan*, 567 A.2d at 1286 ("When it becomes clear that [an] auction will result in a change of corporate control, the board must act in a neutral manner to encourage the highest possible price for shareholders.").

A broad reading of change of control which encompasses all tender offers for a controlling block of target stock is more consistent with the common understanding of the phrase. *See, e.g.*, *Ivanhoe Partners*, 535 A.2d at 1343 (discussing the potential for a bidding corporation to "purchase a controlling interest"); Reder, *supra* note 91, at 281 ("Every corporate takeover necessarily involves a change in control . . . ."). The American Law Institute adopted a definition of "transaction in control" which includes mergers, consolidations, and other transactions involving "an issuance of voting equity securities . . . to effect an acquisition of the assets of another corporation . . . or . . . an issuance of voting equity securities in exchange for at least a majority of the voting equity securities of another corporation." 1 A.L.I. PRINCIPLES, *supra* note 14, § 1.38(a)(1). *But see* Mitchell, *supra* note 15, at 615-19 (lauding Chancellor Allen's analysis in *Time* distinguishing a change of control situation from one where stock is held by public stockholders generally).

[164]"[W]here a potential sale of control by a corporation is not the consequence of a board's action, this Court has recognized the prerogative of a board of directors to resist a third party's unsolicited acquisition proposal or offer." *QVC*, 637 A.2d at 43 n.13.

to attempt to characterize hostile bids as threatening a change of control to justify defensive tactics. This result is problematic because all successful tender offers for a controlling block of target stock, as well as share exchanges in many mergers, leave remaining target stockholders in a minority position. Finally, *QVC* may distort the market for merger partners; the court's change of control analysis creates an incentive for public corporations to merge only with other widely held public corporations.[165]

Along with describing what conditions trigger target directors' duty to maximize stockholder value, the court in *QVC* discussed the content of that duty. The court stated that the consequences of a sale of control impose on directors the special obligation to seek the transaction which offers the best value reasonably available to stockholders.[166] The court further established that the directors' fiduciary duties in a sale of control are the duties of loyalty and care.[167] Next, the court suggested methods by which a board can fulfill its obligation to maximize value for shareholders, including auctions and canvassing the market.[168] Finally, the court described how target boards should evaluate competing bids:

> In determining which alternative provides the best value for the stockholders, a board of directors is not limited to considering only the amount of cash involved, and is not required to ignore totally its view of the future value of a strategic alliance. Instead, the directors should analyze the entire situation and evaluate in a disciplined manner the consideration being offered. Where stock or other non-cash consideration is involved, the board should try to quantify its value, if feasible, to achieve an objective comparison of the alternatives. In addition, the board may assess a variety of practical considerations relating to each alternative.[169]

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[165]This is not necessarily a misincentive in light of *QVC*'s concerns regarding minority stockholders. Nevertheless, the court did not attempt to explain how its concern justifies deterring business combinations solely because one of the corporations has a majority stockholder. Delaware law already affords at least minimal protection to minority stockholders. *See* 2 ERNEST L. FOLK, III ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 262 (3d ed. 1992 & Supp. 1993) (discussing Delaware's appraisal remedy).

[166]*QVC*, 637 A.2d at 43.

[167]*Id.*

[168]*Id.* at 44. The court's reasoning makes it clear that target directors need not conduct an auction in every case.

[169]*Id.* (citation and footnote omitted). While the court allows for consideration of long-term strategic value, it is worth noting that the court did not cite *Time* for this proposition. This fact suggests that the court did not intend to reaffirm *Time*'s extensive reliance on directors' long-term plans. *See supra* notes 101, 111-13, 116 and accompanying text.

The court quoted *Mills Acquisition*, 559 A.2d at 1282 n.29, listing relevant factors for

Despite the complexity of these factors, the court concluded that "the board's goal is straightforward: Having informed themselves of all material information reasonably available, the directors must decide which alternative is most likely to offer the best value reasonably available to the stockholders."[170]

The court's requirement that target boards use objective standards to measure competing bids is significant because it eliminates a justification for defensive tactics. For example, the value of non-cash consideration which bidders offer to target stockholders, like all securities, changes over time. As a result, target boards have discretion in determining how to evaluate competing bids; boards might choose to value the consideration offered by the bidders either at the time the bids are made, or as of the time the stockholders will receive the consideration, or at some intervening time. Therefore, target boards are able to manipulate the value of competing bids to justify a preference for one bidder over another.[171] However, the court in *QVC* stated in a footnote that "[w]hen assessing the value of non-cash consideration, a board should focus on its value as of the date it will be received by the stockholders."[172] This requirement maximizes stockholder choice, rather than aiding target boards who wish to entrench themselves.

The *QVC* court also addressed its enhanced scrutiny of target defenses.[173] The court cited *Mills Acquisition*[174] for the proposition that once the duty to maximize stockholder value devolves, target directors' unequal treatment of competing bidders will continue to be subject to enhanced scrutiny before the business judgment rule will apply.[175] The court set out the relevant features of enhanced scrutiny as follows:

> (a) a judicial determination regarding the adequacy of the decisionmaking [sic] process employed by the directors, including the information on which the directors based their

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consideration including:

> [an offer's] fairness and feasibility; the proposed or actual financing for the offer, and the consequences of that financing; questions of illegality; . . . the risk of non-consumation [sic]; . . . the bidder's identity, prior background and other business venture experiences; and the bidder's business plans for the corporation and their effects on stockholder interests.

QVC, 637 A.2d at 44. Notably, *QVC* omitted language in *Mills Acquisition* which included nonstockholder constituents' interests in this list of factors. *See id.*

[170]*QVC*, 637 A.2d at 45.

[171]*See supra* note 30.

[172]*QVC*, 637 A.2d at 44 n.14.

[173]*Id.* at 45.

[174]Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261 (Del. 1989).

[175]*QVC*, 637 A.2d at 45.

> decision; and (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing. The directors have the burden of proving that they were adequately informed and acted reasonably.[176]

The court softened this test with the admonition that when applying enhanced judicial scrutiny a court should decide whether the "directors made a reasonable decision, not a perfect decision."[177]

Finally, the court found that Paramount's board had breached its fiduciary duties to its stockholders. First, the court found the board to be remiss in failing to recognize the "draconian" nature of certain features of the stock option and the restrictive nature of the no shop agreement adopted in the initial merger agreement.[178] The court found the Paramount board's failure to use QVC's offer as leverage to alter or remove the defensive measures from the amended merger agreement with Viacom to be especially problematic.[179] The court found these devices to be very counter-productive. Therefore, Paramount breached its fiduciary duty by making no effort to eliminate them.[180] Finally, the court found that the Paramount directors "squandered" their last opportunity to negotiate with QVC when they voted on November 15 to recommend the Viacom transaction to their stockholders.[181]

Only future decisions will demonstrate *QVC*'s ultimate impact. Despite the court's flawed change of control analysis, the court revived *Revlon*'s emphasis on maximizing stockholder value. While *QVC* did not

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[176] *Id.*

[177] *Id.*

[178] *Id.* at 49. The court refused to accept Paramount's argument that the no shop agreement prevented it from considering the QVC offer even as it became clear that the QVC offer might be superior to the Viacom merger: "Whether or not it could validly have operated here . . . to prevent Paramount from actively 'shopping' the company, it could not prevent the Paramount directors from carrying out their fiduciary duties in considering unsolicited bids or in negotiating for the best value reasonably available to the stockholders." *Id.* at 49 n.20 (citation omitted).

[179] *QVC*, 637 A.2d at 49-50. Specifically, the court stated:

> The Paramount directors had the opportunity . . . to take appropriate action to modify the improper defensive measures as well as to improve the economic terms of the Paramount-Viacom transaction. [I]t should have been clear to the Paramount Board that the Stock Option Agreement, coupled with the Termination Fee and the No-Shop Clause, were impeding the realization of the best value reasonably available to the Paramount stockholders. Nevertheless, the Paramount Board made no effort to eliminate or modify these counterproductive devices . . . .

Id. at 50.

[180] *Id.* at 50.

[181] *Id.*

overrule *Time*, the court was not receptive of Paramount's argument that the Viacom merger justified the defensive tactics because the merger was an extension of Paramount's long-term business plan.[182] Part IV of this article argues that courts should follow *QVC*'s lead by limiting target directors' discretion in response to hostile takeovers and requiring them to auction off their corporations when they adopt defenses which are not in the target stockholders' interests.

IV. STOCKHOLDER CHOICE AND TARGET DIRECTORS' DUTY TO MAXIMIZE STOCKHOLDER WEALTH

Delaware courts should restrict target directors' discretion in response to hostile takeover bids to align target directors' incentives with their stockholders' interests. Part IV(A) proposes a rule which limits target directors to defenses which unambiguously enhance their stockholders' ability to choose between competing offers. Courts applying this rule would require directors who employ impermissible defensive tactics to auction off their firms. Part IV(B) describes the appropriate role for target directors in response to hostile takeover bids. The proposed rule provides directors with sufficient discretion to protect their stockholders from abusive bids.

A. *A Proposal*

Courts should adopt a rule which comports with the stockholder choice paradigm discussed in Part I of this article by severely limiting target directors' discretion in response to hostile takeover bids. Under the proposed rule, courts would require target directors to make an initial showing that challenged defenses enhance target stockholders' ability to choose which, if any, pending offer to accept. Courts should read this requirement narrowly, permitting only two types of defensive tactics: (1) those providing stockholders an opportunity to vote whether or not they want an offer to succeed independent of their choice to tender if it does succeed,[183] and (2) those providing alternative transactions through management buyouts or by inducing additional bidders. Courts should also require target directors to demonstrate that challenged defenses are structured to enhance stockholder choice.[184] If target directors satisfy this test, reviewing courts should allow

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[182]*See id.* at 51 ("[The Paramount directors] view of the strategic alliance [with Viacom] became an empty rationalization . . . .").

[183]*See supra* notes 47-51 and accompanying text (proposing legislation by which the current letter of transmittal would be restructured to allow shareholders to indicate whether they wish the tender offer to succeed and whether they wish to tender their shares if the bid fails).

[184]This is a procedural check similar to the Delaware court's analysis suggesting that bidders should generally be treated equally once an auction begins. *See Mills Acquisition*, 559

the presumptions of the business judgment rule to apply to the directors' actions. Finally, courts should require target directors employing defenses which are not clearly choice enhancing to conduct an auction. This requirement would maximize shareholder value and dissuade directors from using impermissible defenses.

1. The Permissible Defenses

The proposed rule limits target directors' discretion to employing only those defenses which unambiguously promote stockholder choice. First, target boards may act to negate the coercive aspects of tender offers by providing target stockholders with an opportunity to vote for the outcome they prefer. However, stockholders should retain the right to tender into a successful offer even if they voted against it.[185] In *CTS Corp. v. Dynamics Corp. of America*,[186] the United States Supreme Court ruled that an Indiana "Control Share Acquisitions" statute granting similar voting rights to target stockholders is constitutional.[187] The Indiana Act prevents an entity which acquires a triggering percentage of target stock from voting those shares unless a majority of target stockholders votes to grant the acquiror voting rights.[188] The requisite vote occurs at the next regularly scheduled shareholders meeting, but the acquiror can insist on a vote within fifty days after announcing its offer if it is willing to pay the associated costs.[189]

Courts should permit corporations which are not governed by "Control Share Acquisitions" statutes to adopt charter amendments requiring bidders

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A.2d at 1286-87.

Timing, for instance, is crucial to tender offers. Courts should not permit target directors to time a management buyout transaction so that it will close before a competing bid closes. Stockholders who believe a first bid will succeed are likely to tender into that bid in order to capture a pro rata share of the front-end premium even if they prefer the consideration offered by a subsequent bid. *See AC Acquisitions*, 519 A.2d at 114 (attempting to formulate an injunction which would prevent the challenged "Company Transaction" from using a timing advantage to preclude a hostile bid while allowing target stockholders to tender into the company transaction if they desired).

[185]Professor Bebchuk first proposed this approach as a legislative solution. *See supra* notes 47-50 and accompanying text.

[186]481 U.S. 69 (1987).

[187]*Id.* at 94. "The principal result of the Act is to grant shareholders the power to deliberate collectively about the merits of tender offers." *Id.* at 82 n.7. The Court held that the Indiana statute was neither preempted by the Williams Act nor a violation of the Commerce Clause. *Id.* at 94. Several states have adopted provisions similar to the Indiana statute. *See* Michael K. L. Wager & Amy R. Kaplan, *State Antitakeover Legislation: Necessary Protections or Rationalization of Entrenchment?*, INSIGHTS, Feb. 1990, at 26, 27 (stating that 23 states have adopted such statutes).

[188]*CTS*, 481 U.S. at 73-74.

[189]*Id.* at 74-75.

to provide target stockholders an opportunity to vote whether they wish a proposed bid to succeed.[190] In addition, courts should allow corporations to include charter provisions which allow stockholders to indicate which offer they prefer in the case of multiple bids. Furthermore, courts should require directors adopting such charter amendments to demonstrate that the defense is not structured to preclude hostile offers.[191] Most notably, courts should not permit target directors to use such provisions to prolong a control contest indefinitely.[192] For example, courts might require an immediate auction if a challenged charter provision delayed the stockholder vote by a time period longer than that allowed by the Indiana Act.

These measures serve stockholder choice in two ways. First, stockholders who might otherwise feel coerced to tender into an inadequate

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[190]These charter amendments, like the Indiana statute, should specify the percentage of target stock which a hostile bidder must bid for to trigger the duty to provide a stockholder vote. The amendment might enforce a stockholder vote rejecting a hostile offer by establishing contingent voting rights as in the Indiana statute, or by employing preclusive defenses such as a poison pill.

While a number of commentators have criticized "Control Share Acquisitions" statutes, see, e.g., Paul N. Cox, *The Constitutional "Dynamics" of the Internal Affairs Rule — A Comment on* CTS Corporation, 13 J. CORP. L. 317 (1988); Donald C. Langevoort, *The Supreme Court and the Politics of Corporate Takeovers: A Comment on* CTS Corp. v. Dynamics Corp. of America, 101 HARV. L. REV. 96 (1987), these criticisms have focused on states' intent to use these measures to deter tender offers. *See* Cox, *supra*, at 364 ("[T]he undeniable legislative purpose was to inhibit tender offers . . . ."); Langevoort, *supra*, at 105-07 (arguing states' likely reason to adopt blanket statutes rather than leaving corporate directors to adopt charter amendments with the same effect was to deter hostile tender offers). It is true that the voting requirement adds to the cost and risk associated with a hostile tender offer. Absent other target defenses, however, stockholder voting is unlikely to have any significant deterrent effect on bidders offering a premium for target stock. *See* GILSON, *supra* note 65, at 742 (Supp. 1992) (arguing bidders prefer providing stockholders an opportunity to vote whether or not to accept an offer to a regime permitting preclusive defenses because the proposed approach prevents interference by target directors); 5 LOSS & SELIGMAN, *supra* note 4, at 2291-92 (arguing laws such as the Indiana Act pose little threat to the basic policy of the Williams Act).

[191]The voting form might be complicated if multiple bidders make offers for the same target. Stockholders must be able to indicate their order of preference for the various possible outcomes, including the incumbent board's retaining control of the target. They must also be able to indicate which offers they would like to tender into if those offers receive a sufficient vote. *See* Bebchuk, *Toward Undistorted Choice*, *supra* note 1, at 1748. Courts should require target directors to demonstrate that challenged charter provisions do not build in a preference for the board's preferred bidder, but are designed to allow target stockholders to make a free choice between competing offers.

[192]While some delay may be beneficial in providing competing bidders an opportunity to enter an auction, *see* Bebchuk, Comment, *supra* note 1, at 1051-54, the costs and uncertainty imposed on bidders by unlimited delay, *see supra* note 65, would eventually serve as an effective bar on hostile offers. *See* Easterbrook & Fischel, *Auctions*, *supra* note 1, at 8-9 (arguing auctions necessarily result in fewer hostile offers).

two-tiered bid would be free to vote against the offer without losing the opportunity to tender if a majority of stockholders favored the bid. Second, by allowing the stockholders to specify which of competing bids they prefer to succeed, target directors could ensure their stockholders weren't forced to tender into a bid simply because it would close before a more valuable offer.[193] Additionally, a structured stockholder vote would provide target directors an opportunity to disseminate nonpublic information about the target either to the public or to potential bidders.

The proposed rule also allows target directors to provide their stockholders with alternatives to a hostile takeover bid. The target may offer to repurchase a controlling block of target stock from its stockholders for a greater premium than that offered by the hostile bidder.[194] Courts should permit a defensive share repurchase if it satisfies two conditions. First, courts should not allow target directors to structure a management buyout or similar transaction to preclude other bids, for instance, by timing a management buyout to close before a hostile bidder can complete its offer. Second, courts should bar target directors from repurchasing stock exclusively from the bidder at a premium over the market price.[195] Absent these circumstances, courts should allow management buyouts because an incumbent management willing to pay more for target stock than any outside bidder is likely to put the target assets to their best use.[196]

Target directors may also offer their stockholders alternatives to hostile bids by encouraging additional bidders. Courts should allow target boards to provide nonpublic information about the target to potential bidders,[197] provided that the target makes such information available to all bidders.[198] Additionally, courts should enforce reasonable "termination fee" agreements which offset an unsuccessful bidder's transaction costs.[199] Courts

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[193]*See supra* note 184.

[194]*See supra* notes 73-74 and accompanying text.

[195]The practice of paying inflated prices to repurchase shares from potential acquirors is known as greenmail, *see, e.g.*, 5 LOSS & SELIGMAN, *supra* note 4, at 2301; FERRARA ET AL., *supra* note 30, at 413-23, and has been heavily criticized. *See, e.g.*, *Unocal Corp.*, 493 A.2d at 956 (classifying the plaintiff as "a corporate raider with a national reputation as a 'greenmailer'"); Coffee, *supra* note 1, at 1290 (characterizing greenmail as "perverse"). Congress recently amended the Internal Revenue Code to impose a stiff tax on the receipt of greenmail. For a general discussion of greenmail, see Edward A. Zelinsky, *Greenmail, Golden Parachutes and the Internal Revenue Code: A Tax Policy Critique of Sections 280G, 4999 and 5881*, 35 VILL. L. REV. 131 (1990).

[196]*See supra* note 74.

[197]*See* Bebchuk, Comment, *supra* note 1, at 1030; Bradford, *supra* note 24, at 435.

[198]*See Mills Acquisition*, 559 A.2d at 1283, 1288. Otherwise, target directors might skew an auction by providing information about the target's value only to the preferred bidder. *Id.*

[199]The chancery court in *QVC* allowed a termination fee, *see QVC*, 637 A.2d at 36-37, and QVC did not appeal that ruling. Termination fees allow self-interested target boards to favor

should not, however, enforce "lockup" agreements between target boards and their preferred bidders.[200] Lockups deny stockholders the ability to choose competing bids on their terms because they decrease the value of those bids.[201] While the target board's preferred bidder may offer more to stockholders, allowing lockups decreases the total expected value represented by the competing bids.[202] Lockup agreements are most likely the result of the target directors' desire to merge with a white knight[203] rather than a desire to maximize stockholder value.

2. Management Incentives

The proposed rule aligns directors' incentives with their stockholders' interests. Although directors might use preclusive defenses to their stockholders' benefit in some cases, the potential for directors to use defensive tactics to their own advantage justifies limiting target directors' discretion.[204] If courts deny target directors the ability to use preclusive defenses, those directors will have an incentive to seek alternative

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one bidder; nevertheless, they may be reasonable to entice a bidder who is not prepared to bid at the present time.

[200]Lockups entail agreements to sell target assets or securities to a preferred bidder at a discount if another bidder wins the auction. *See* FERRARA ET AL., *supra* note 30, at 466-85.

[201]The total consideration paid to target stockholders by a successful bidder (other than the bidder benefitting from the lockup) should reflect the fact that value has been siphoned from the corporation in the discount sale. As a result, the successful bidder is likely to reduce the consideration it is willing to pay in a back-end offer for remaining target shares.

[202]This expected value is the sum of two products; the product of the likelihood that the initial bidder will succeed, multiplied by the value of that bid, plus the product of the likelihood that the second bid will succeed, multiplied by the value of that bid. *See* Easterbrook & Fischel, *Proper Role*, *supra* note 1, at 1164 (explaining that the value of any stock is "the sum of two components: the price that will prevail in the market if there is no successful offer (multiplied by the likelihood that there will be none) and the price that will be paid in a future tender offer (multiplied by the likelihood that some offer will succeed)" and stating that on any given day, the stock's price will be the "composite of the prices the stock would assume under different assumptions about the future"). A white knight unwilling to enter an auction without valuable consideration from the target is likely a lower valued user than the initial bidder. As a result, the higher value of the white knight's bid is unlikely to exceed that of the initial bid by enough to offset the decrease in the value of the initial bid effectuated by the lockup. *See supra* note 201. Lockups are not efficient even if a white knight's bid entices the initial bidder to make a new, higher bid in response to the white knight's bid. If the target stock ends up in the hands of the initial bidder the assets still move to their highest valued use, but the artificially high competing bid did nothing to facilitate this result. The increased consideration paid to target stockholders does not serve any independent social function. *See* Easterbrook & Fischel, *Proper Role*, *supra* note 1, at 1174-75.

[203]*See* FERRARA ET AL., *supra* note 30, at 461-66 (discussing target managers' reasons for preferring one bidder over another).

[204]*See supra* note 30.

transactions for stockholders. Target directors who wish to retain their positions will be compelled to offer a management buyout or to induce a friendly bidder to provide more consideration to target stockholders than the hostile bidder. Also, target directors who hold target stock will have an incentive to capture a pro rata share of the highest possible premium in a tender offer.[205] While directors might act in a self-interested way under this regime, their actions would only serve to benefit their stockholders.

The proposed rule further promotes stockholders' interests by requiring target directors who employ impermissible defenses to maximize value for their stockholders in an auction. The *QVC* court's most persuasive rationale for requiring targets to maximize stockholder value is applicable to all tender offers for a controlling block of target stock. The court emphasized that target stockholders have only one chance to obtain a control premium: "Once control has shifted, the current . . . stockholders will have no leverage in the future to demand another control premium."[206] Courts should not allow target directors to prevent their stockholders from collecting a premium for their target stock, but should allow their stockholders to choose the offer which extends the most consideration.[207] This analysis suggests that courts might reasonably require all target directors to auction off their corporations.[208]

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[205]*See* Gilson, *supra* note 1, at 66-67 n.36. Professor Gilson discusses directors' incentives:

> But what happens to management's incentives when defensive tactics are prohibited? The prohibition should convince the managers of a potential target that the company cannot remain independent if an offer is made at more than the market price, and this will affect how they will behave in the pre[-]offer period when they perceive their company a likely target. . . . [W]hen managers believe that the company is worth more than market value, they have a substantial incentive, now undiluted by the option of continued independence, to sell the company in a fashion that allows them to share in the gain.

Id. Professor Gilson further argues that this approach would have the effect of promoting negotiated sales prior to any hostile bid. *Id. But see* Bebchuk, *A Reply*, *supra* note 1, at 25-26 n.8 (rejecting Gilson's opinion of the unimportance of the auctioneering process and, in contrast, arguing that auctions serve "as a check on a self-serving management").

[206]*QVC*, 637 A.2d at 43.

[207]*See* Coffee, *supra* note 1, at 1220. Professor Coffee states:

> So long as fiduciary duties essentially depend upon the existence of a principal-agent relationship, it is a conceptual self-contradiction to define the fiduciary's duty so that the principal cannot instruct his agent to seek a higher premium. Nor, should the agent be permitted to ignore his principal's instructions because more enlightened shareholders would decide otherwise.

Id.

[208]Professor Bebchuk advocates this pure auction requirement, *see* Bebchuk, Comment, *supra* note 1; Bebchuk, *A Reply*, *supra* note 1, but the Delaware Supreme Court has explicitly refused to adopt it. *See supra* note 91.

The proposed rule provides target directors with slightly more discretion in facilitating defenses which are clearly in stockholders' best interests than is available with a pure auction requirement. Once target directors have used defenses to their advantage, however, they should be required to auction the target. Only an auction can ensure a fair result for target stockholders once target defenses have skewed a control contest in favor of one bidder.[209] Additionally, directors who realize they will be forced to conduct an auction are more likely to pursue alternative transactions which benefit their stockholders. In contrast, self-interested directors who believe that a court will only rescind any impermissible defenses will view use of them as essentially a riskless gamble. Under the proposed rule, target directors effectively have a choice between doing nothing and employing defenses which promote their stockholders' ability to make a free choice between offers. This approach leaves the ultimate decision whether to accept a tender offer in the hands of the actor best positioned to evaluate the offer: the target stockholders.[210]

3. Efficiency Gains

The proposed rule serves the twin purposes of the stockholder choice paradigm discussed in Part I. Stockholder choice serves as a monitor of directors' effectiveness. Target stockholders will replace inefficient directors by tendering into hostile bids which offer a premium for target stock.[211] Stockholder choice also facilitates target assets' movement to their most highly valued use by giving target directors a strong incentive to pursue

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[209]In *QVC*, Viacom initiated its tender offer two days before QVC opened its offer. *QVC*, 637 A.2d at 41. This timing advantage might have ensured Viacom's success if Paramount's defenses were simply not permitted. Only the auction requirement, represented by the Paramount directors' duty to maximize value for their stockholders in *QVC*, can ensure meaningful stockholder choice once directors have used a choice impeding defense.

[210]*See supra* notes 14-36 and accompanying text.

[211]*See supra* notes 25-28 and accompanying text. The proposed rule's disciplinary function is especially appropriate in light of the fact that recent corporate law developments have left corporate directors a great deal of leeway to pursue their own self-interests:

> [C]orporate America is now governed by directors who are largely impervious to capital market or electoral challenges. Until very recently, the principal post-takeover form of external discipline on American management was the prospect of insolvency due to product market competition, but this relief arrives only after management missteps have destroyed millions or even billions of dollars of value. An influential observer of the corporate scene thus laments that absent new monitoring strategies "the walls around the corporate castle are higher now, and the moat wider, than ever before."

Joseph A. Grundfest, *Just Vote No: A Minimalist Strategy for Dealing with Barbarians Inside the Gates*, 45 STAN. L. REV. 857, 864 (1993) (footnotes omitted); *see also id.* at 869-903 (discussing evidence of U.S. corporate managers' underperformance in recent years).

higher valued bids.[212] Target stockholders will choose the offer providing them the most consideration, ensuring that the most highly valued user obtains the target's assets.[213]

The proposed rule encourages efficient corporate management by limiting target directors' discretion in response to tender offers. Efficient management should dissuade potential bidders from believing that they can make better use of the corporation's assets.[214] Martin Lipton argues that a rule limiting target directors' discretion would simply force corporate directors to focus on short-term gains to avoid hostile bids.[215] However, economic theory and empirical evidence suggest that stock prices generally reflect the long-term value of corporations' assets under current management.[216] As a result, directors barred from using preclusive defenses would have a strong incentive to maximize their stockholders' overall value through efficient management, thus avoiding hostile bids.[217]

Even if the proposed rule would cause target directors to adopt a short-term focus in some cases, the potential harms of this result must be weighed against the advantages of the proposed rule. By barring most target defenses, the rule would prevent costly litigation over tender offer defenses and social losses associated with self-interested directors' ability to block efficient offers. Additionally, a short-term focus may be an appropriate response to tender offers in some cases, providing incumbent directors with an opportunity to demonstrate that previously unexploited corporate opportunities make the target worth more than the offer price. Finally, it is worth noting that even target directors who have defenses available to them

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[212]*See supra* notes 14-36, 205 and accompanying text.

[213]*See supra* note 31 and accompanying text.

[214]*See* Easterbrook & Fischel, *Proper Role*, *supra* note 1, at 1173-74.

[215]*See* Lipton, *Takeover Bids*, *supra* note 1, at 109-10. Mr. Lipton argues that a short-term focus would prevent target directors from pursuing "socially beneficial objectives such as expanding the enterprise, improving productivity, and cultivating planning, research, and development." Lipton, *Corporate Governance*, *supra* note 1, at 8-9.

[216]*See* Easterbrook & Fischel, *Proper Role*, *supra* note 1, at 1183-84; *see generally* GILSON, *supra* note 65, at 158-71 (Supp. 1992) (surveying empirical evidence relating to the "efficient market hypothesis"). Some circumstances, such as a thin market in a corporation's stock, may prevent the corporation's stock price from reflecting all public information about the corporation. *Cf.* 5 LOSS & SELIGMAN, *supra* note 4, at 3509 (noting public "[i]nformation can be readily reflected in stock prices" where the issuing corporation "is followed by securities analysts and professional investors"). Under these circumstances, however, there is little reason to believe that corporate directors can systematically predict circumstances where a short-term focus (which is detrimental to the corporation's long-term value) will result in increased stock prices.

[217]*See* Easterbrook & Fischel, *Proper Role*, *supra* note 1, at 1183-84. *But cf.* Coffee, *supra* note 1, at 1206-11 (discussing empirical evidence suggesting that there is little correlation between target firms and inefficiently managed firms).

may attempt to prevent hostile offers by boosting short-term value to prevent hostile offers unless they know they have complete discretion to bar hostile offers. As a result, target directors' increased use of this strategy under the proposed rule is not likely to be as significant as Mr. Lipton suggests.

By promoting auctions, the proposed rule facilitates target assets' movement to their highest valued uses. The rule promotes auctions in two ways. First, target directors faced with a hostile bid for a controlling block of target stock may offer their stockholders an alternative bid if they are not allowed to use preclusive defenses.[218] Second, courts finding that directors have employed impermissible defenses will require those directors to auction off their corporations. Auctions will often increase the premium which target stockholders receive. More importantly, competing bids facilitate target assets' movement to their most highly valued use.[219] The proposed rule also encourages directors considering a merger to seek the transaction offering the greatest value to their stockholders.[220] Directors will realize that any other transaction would be subject to interference from outside bids.

The proposed rule balances the competing benefits of tender offers,[221] while providing target directors sufficient discretion to prevent bidders from coercing target stockholders. The proposed rule may be less effective at promoting monitoring than a rule requiring target managers to remain entirely passive in response to hostile offers. This is because both auctions and stockholder voting increase the cost of tender offers and, as a result, may deter some offers on the margin.[222] Additionally, the proposed rule may be less effective than a pure auction requirement at facilitating target assets' movement to their most highly valued use because the rule does not require target directors to auction off their corporations.[223] Nevertheless, the proposed rule achieves significant efficiency gains over current legal rules governing tender offers, while leaving target directors free to take steps consonant with their fiduciary duties.

B. *Target Directors' Role Under the Proposed Rule*

The proposed rule ensures that stockholders can make a reasoned and uncoerced evaluation of tender offers. Commentators critical of a rule limiting target directors' discretion argue that such an approach would

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[218] *See supra* notes 14-36, 205 and accompanying text.

[219] *See supra* note 31.

[220] *See* Bebchuk, Comment, *supra* note 1, at 1044-45. *But see* Herzel et al., *supra* note 1, at 109 (arguing directors must have discretion in order to effectively negotiate on their stockholders' behalf).

[221] *See supra* note 31.

[222] *See* Easterbrook & Fischel, *Auctions*, *supra* note 1, at 10-12.

[223] *See* Bebchuk, Comment, *supra* note 1, at 1039-41.

inappropriately strip directors of their ability to determine when a merger is appropriate. As a result, public corporations would always be for sale.[224] Martin Lipton argues that this result is no different from requiring corporate directors to "determine annually whether it would be possible to sell or liquidate the company at a substantial premium."[225] However, there is a crucial difference between these two approaches. Corporate directors might reasonably determine that an annual decision whether to liquidate is an inefficient use of time and resources or is otherwise inappropriate. In contrast, where a hostile bidder offers a premium for a controlling block of target shares, target directors are confronted with the possibility that they may not be making the best use of corporate assets. Confronted with this situation, target directors are no longer in the best position to evaluate their stockholders' interests. Therefore, the final decision whether to tender should be left to the stockholders.[226]

The proposed rule leaves target directors sufficient discretion to prevent truly undervalued bids.[227] Bidders, of course, have an incentive to

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[224]*See* Herzel et al., *supra* note 1, at 109-10; Lipton, *Takeover Bids*, *supra* note 1, at 109. These authors contrast tender offers to negotiated transactions where directors are not permitted to submit a proposed merger to their stockholders without first determining that the deal is beneficial. Hostile tender offers provide a check on incumbent boards' ability to evaluate proposed mergers. *See* Bebchuk, Comment, *supra* note 1, at 1044-45; *see also supra* notes 25-28 and accompanying text (discussing how stockholder choice helps to discipline ineffective boards).

[225]Lipton, *Takeover Bids*, *supra* note 1, at 109. Mr. Lipton argues that a broad rule limiting target directors' discretion in response to tender offers would harm the national economy. He argues that courts would inappropriately disadvantage nonstockholder constituents by limiting target directors' discretion. *See id.* at 115. *But see supra* note 15 (arguing that directors can not adequately protect nonstockholder constituents' interests while fulfilling their shareholders' needs). Mr. Lipton argues further that limiting target directors' discretion would promote undesirable debt formation. *See* Lipton, *Corporate Governance*, *supra* note 1, at 9, 20-23. *But see* C. Steven Bradford, *Protecting Shareholders from Themselves? A Policy and Constitutional Review of a State Takeover Statute*, 67 NEB. L. REV. 459, 523-27 (1988) (suggesting shareholders have no interest in the wealth effects on creditors as long as the proposed takeover maximizes value for stockholders). These economic policy arguments made by Mr. Lipton are too broad in scope to be addressed by the judiciary and are best treated, if at all, by legislative action.

[226]*See supra* notes 14-36 and accompanying text.

[227]What constitutes an undervalued bid is a difficult question. A number of Delaware opinions have assumed that corporations have an "intrinsic value." *See, e.g.*, *Van Gorkom*, 488 A.2d at 874 (holding directors had not made an informed business judgment, in part because they "were uninformed as to the intrinsic value of the Company"). Under this view, an undervalued bid is one offering target stockholders less than the target's intrinsic value. *See Revlon*, 506 A.2d at 181 (noting the target's initial defenses were justified because they protected its stockholders from a bid representing less than the target's intrinsic value); *see also* Lipton, *Takeover Bids*, *supra* note 1, at 108 (arguing that many corporations are undervalued by the stock market, making them vulnerable to tender offers). *But see* 1 A.L.I. PRINCIPLES,

purchase targets at the cheapest possible price. Mr. Lipton argues that a large percentage of stock is owned by professional investors who have an institutional motivation to seek quick profits.[228] This argument makes the success of most tender offers a "foregone conclusion." Stockholders who believe an offer will succeed due to institutional investors' willingness to tender will also tender to capture a pro rata portion of the front-end consideration.[229] Thus, bidders can take advantage of the market structure to force bargain sales on targets and their stockholders.

Target directors' ability to protect their stockholders from undervalued or coercive bids under the proposed rule is best illustrated by an example. Assume that T Company (T), a Delaware corporation, has adopted charter amendments providing T's stockholders with voting rights similar to those in Indiana's "Control Share Acquisitions" statute.[230] T has one class of voting stock which currently trades over the counter for $40 per share. T's engineers have recently discovered a mineral deposit which T's directors

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supra note 14, § 6.01, cmt. a(2)(e)(1), at 394 ("For purposes of the business judgment rule, a corporation has no single intrinsic value . . . .").

This article adopts the position that stockholders benefit whenever they receive a premium over the target's market price. The "efficient capital markets" hypothesis holds that stock prices reflect all publicly available information about the relevant corporation. *See* Easterbrook & Fischel, *Proper Roles*, *supra* note 1, at 1165-68 (describing the theory). The hypothesis implies that a corporation has no "true" or "intrinsic" value. Rather, the value of a corporation varies over time as reflected in stock prices. Under this view, target stockholders benefit by receiving any premium.

Professors Easterbrook and Fischel point out that the tender offer mechanism is appropriate even if target stock is undervalued. For instance, if the target stock "is indeed undervalued, there is too little investment in that industry; investors apparently are not anticipating returns commensurate with reality. Correction of the undervaluation via tender offers would produce more appropriate investment incentives, just as would correction via the arbitrage function of other professional investors." Easterbrook & Fischel, *Auctions*, *supra* note 1, at 11. Moreover, a tender offer may give target stockholders their only opportunity to realize the gain represented by the difference between the target's market value and it's "true" value. *See* Bradford, *supra* note 24, at 435.

While the issue of what constitutes a truly undervalued bid is beyond the scope of this article, the operation of the proposed rule does not depend on whether or not a bid is undervalued. Target directors are limited to specific defenses in response to any hostile bid. This approach avoids the doctrinal difficulties surrounding the relevance and determination of a target's intrinsic value.

[228]Lipton, *Takeover Bids*, *supra* note 1, at 114.

[229]*Id.* at 113-14; *see also* Richard A. Booth, *The Problem with Federal Tender Offer Law*, 77 CAL. L. REV. 707, 713-18 (1989) (arguing that holdings by institutional investors as well as the functioning of the Williams Act put pressure on target stockholders to tender). This circumstance worsens the "prisoner's dilemma" faced by target stockholders in a two-tiered bid. *See supra* notes 43-46 and accompanying text. *But see* Bradford, *supra* note 24, at 456-57 (arguing that institutional investors can use their market power to overcome stockholders' traditional collective action problems and prevent undervalued bids).

[230]*See supra* notes 186-89 and accompanying text.

believe will allow T to significantly increase its operations and revenues. The board is planning to announce the discovery at a shareholders' meeting in three months, after additional research is completed. T's investment bankers have advised the board that T stock will likely trade at about $60 per share after the announcement.

T's charter requires any entity making a tender offer which would raise that entity's holdings in T to thirty percent or more of T's outstanding stock to provide T's existing stockholders an opportunity to vote whether or not the bidder, if successful, will have the right to vote the shares it acquires. T's charter also provides that if multiple bidders make offers for T stock, the voting proxy must provide T's stockholders an opportunity to indicate which offer they prefer. The charter further specifies that the vote will occur at T's next regularly scheduled stockholders meeting after a tender offer is initiated unless the hostile bidder or bidders agree to pay the expense of the vote.[231] Bidders willing to pay the expenses may insist on a vote on the fiftieth day after the first offer was commenced, provided that the vote must occur no less than ten days after any bidder raises its bid.[232]

T's directors have sufficient discretion to prevent an undervalued bid from succeeding without putting T up for auction. Assume that B Corporation, a holding company with no substantial assets of its own, initiates a hostile tender offer for any and all shares of T stock at $50 per share. T's directors believe this bid undervalues T by at least $10 per share. Initially, T's directors may publicly announce their recent mineral discovery. Professor Bebchuk argues that T's stock price will be capped by the $50 offer if T's stockholders feel the bid will succeed.[233] B, however, must offer T's stockholders an opportunity to vote whether they wish B's offer to succeed. This voting opportunity should allow T's stock price to reflect the mineral discovery because it presents a real opportunity for stockholders to reject the bid.[234] Few, if any, of T's stockholders are likely to tender to B

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[231]T's charter provides that any bidder who wishes to be included on the voting form, including T itself if it offers a management buyout, must agree to share the cost of the vote on a pro rata basis.

[232]This provision parallels the Williams Act's requirement that no tender offers may close less than ten days after a bidder increases its bid. 17 C.F.R. § 240.14e-1(b) (1993); *see also* 5 LOSS & SELIGMAN, *supra* note 4, at 2228-30 & n.338 (discussing the Securities Exchange Commission's use of its fraud prevention authority to require all tender offers to be open for at least 20 business days plus 10 after notice of an increase in the bid).

[233]*See* Bebchuk, *Toward Undistorted Choice*, *supra* note 1, at 1727-28. If the stockholders believe that institutional investors holding a sufficient amount of T stock will tender to turn a quick profit, the stockholders will also tender to capture their pro rata share of the front-end offer's consideration. *Id.* at 1728.

[234]*Id.* at 1753-54 & n.143.

for $50 if T's directors are correct in their belief that T stock is worth $60 per share.[235]

T's directors may not block a hostile bid offering their stockholders a premium, but they may pursue their stockholders' interests by inducing additional bids[236] or by offering a management buyout which offers a greater premium than B's hostile bid. Assume that B Corporation revises its offer to T's stockholders, offering cash and securities valued at $63 for each share of T's voting stock. T's board realizes that it will not be able to prevent a change in control because Delaware courts refuse to permit preclusive defenses and B is offering a premium for T stock. Nevertheless, B must provide T's stockholders an opportunity to vote on the proposed offer no sooner than fifty days after the offer is initiated. T's investment bankers inform T that WK, Inc. has been searching for a merger partner with assets similar to T's. T contacts WK,[237] and WK responds that it might be interested in acquiring T. T provides information about its operations to WK, including nonpublic information. T also provides this information to B, however, to prevent B from challenging T's actions. WK offers $90 per share for T stock, and B responds with an offer for $95 share. T's stockholders predictably vote for B's offer, and B obtains control of T.[238]

The proposed rule will result in small premiums in some cases. Assume that in the prior example T's investment banker is unable to identify any bidders interested in competing with B. B's $63 bid will succeed, although it offers little premium to T's stockholders. It is possible that T's stockholders would do better to retain their target stock in these circumstances. It is also possible, however, that B's offer presents T stockholders with their only opportunity to realize a premium on their shares,[239] as evidenced by the fact that B was the only bidder interested in T. The uncertainty here, which depends on information unavailable to courts at the time defenses would be challenged, suggests that courts should apply

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[235]A similar analysis applies if B's offer is two-tiered. Assume B offers $70 per share for 50.1% of T's stock and announces that it will pay remaining stockholders $30 per share in a back-end offer if the front-end offer succeeds. The blended value of this offer is slightly more than $50 per share. Absent a vote, most of T's stockholders would tender to capture a pro rata share of the $70 front-end consideration. Given disclosure of T's mineral discoveries and the opportunity to vote, however, T's stockholders will vote against the offer's success if they believe T stock is worth $60 per share.

[236]*See supra* notes 197-203 and accompanying text.

[237]T's directors are probably stockholders as well. Thus, they have an incentive to seek more highly valued bids even if they are motivated solely by self-interest.

[238]In this case, the initial bidder is also the highest bidder. Nevertheless, T's offer was not useless. It provided a market check ensuring that B was the most highly valued user of T's assets.

[239]*See* Bradford, *supra* note 24, at 435.

the presumption against target directors' discretion, thus, preventing directors from acting in their own interest and potentially harming their stockholders.

Now assume that T has not discovered mineral resources but expects to recover a substantial sum from a law suit it is currently litigating. T's board expects T's stock value to rise to $60 per share when the litigation is resolved and the amount of the recovery disclosed. The board is unwilling to publicly disclose its expected recovery in the law suit, however, because such a disclosure would likely hurt T's bargaining position.[240] Even in these circumstances T's board is not powerless to prevent B's undervalued $50 bid from succeeding. T might disclose its expected recovery to a potential white knight on a confidential basis to induce a higher bid. Also, as in the examples described above, T is free to conduct a management buyout which will offer a premium reflecting the expected settlement.[241] T's board might take advantage of this situation by making an undervalued offer for T stock at some price between $50 and $60. However, T's stockholders would, at least, have an opportunity to sue T's board for a breach of its fiduciary duties. While this example demonstrates that there is still some potential for target director abuse under the proposed rule, the possibility of this type of undervalued management buyout succeeding under unusual facts is insufficient to overcome the rule's overall efficacy.[242]

Mr. Lipton also argues that target directors must retain discretion to protect their stockholders from conditional bids which might adversely effect stockholder interests if they fail. He identifies a number of harms associated with illegal bids:

> The failure of the target to attempt to defeat a tender offer which is later blocked by government or other action may result in loss of key employees, disaffection of customers and suppliers and other problems, with the result that the business

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[240]For a case with similar facts, see *Shamrock Holdings*, 559 A.2d at 289-90; *see supra* notes 64-68 and accompanying text.

[241]Michael Bradley suggests:

> Target managers are always able to structure an intrafirm tender offer that dominates the bid of a corporate raider who attempts to acquire the target at below its pre[-]offer market value. The potential for such a dominating intrafirm tender offer solves the prisoner's dilemma. As a result, value-decreasing bids will never be successful and therefore probably are never made.

Bradley et al., *Synergistic Gains*, *supra* note 8, at 37 (footnote omitted). This statement may be too strong. It assumes that target directors would always be willing to enter into a management buyout transaction and that they would always be able to secure financing.

[242]Additionally, B or another outside bidder, might well respond to T's management buyout with a higher counteroffer. Even if that did not occur, T's abusive management buyout might have given T's stockholders their only opportunity to realize even part of T's value which was not previously reflected in T's market price.

> of the target is damaged and the shareholders never get the opportunity to sell at the tender offer price.[243]

While these concerns are legitimate, they do not justify a deviation from the proposed rule. Courts should encourage target directors to confront a potential bidder with perceived problems, giving the bidder an opportunity to satisfy management's concerns, rather than giving target directors an incentive to interfere with a potentially beneficial offer.[244]

Bidders have limited incentive to make offers which they cannot consummate under the proposed rule. Bidders do occasionally make bids which are subsequently blocked by government action.[245] For example, a bidder might make a bid to threaten the target, coercing the target board to pay the bidder a premium for target shares which the bidder had already obtained.[246] Courts applying the proposed rule would not permit target directors to repurchase stock at a premium,[247] thus, preventing hostile bidders from coercing greenmail from the target directors.

Nevertheless, a bidder might still make a bid which it could not complete to put the target "into play."[248] Such bids play a socially useful role if the bidder has identified a target which another bidder would be willing to acquire at a premium.[249] The initial bidder is rewarded by selling whatever target stock it has purchased to the ultimate bidder for the same premium received by other target stockholders. Absent the potential for greenmail, such bidders have a strong incentive to put into play only those corporations which would eventually be purchased for a premium.[250] As a result, target directors should have little fear of illegal bids. Moreover, there

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[243]Lipton, *Takeover Bids*, *supra* note 1, at 118.

[244]*Cf. QVC*, 637 A.2d at 41 (criticizing Paramount for failing to communicate its concerns regarding the conditionality of QVC's bid to QVC).

[245]*See* Lipton, *Takeover Bids*, *supra* note 1, at 119-20 nn.58-59.

[246]*See* Coffee, *supra* note 1, at 1290-91.

[247]*See supra* note 195 and accompanying text. Forcing the target board to auction off the target in this circumstance would make little sense. Rather, courts should treat greenmail as a duty of loyalty violation, forcing target directors to pay damages to their stockholders representing the premium paid to the hostile bidder. *Cf.* Coffee, *supra* note 1, at 1292-93 (noting courts' "reluctance . . . to impose liability on directors who do not personally profit").

[248]*See* Coffee, *supra* note 1, at 1291-92.

[249]*See* Easterbrook & Fischel, *Auctions*, *supra* note 1, at 10-12 (arguing arbitrageurs may serve a useful function by searching for potential targets); *see also* Coffee, *supra* note 1, at 1291 (suggesting arbitrageurs serve a useful role by identifying companies with a "lackluster market and financial history" and proposing plans for "the realization of its latent value").

[250]Searching for potential targets may be costly. *See* Easterbrook & Fischel, *Auctions*, *supra* note 1, at 3-7 (arguing bidders pay significant search costs to identify potential targets). Absent greenmail, "[a]rbitrageurs would . . . run the risk that no other purchaser would pay a premium for the shares they had acquired." Coffee, *supra* note 1, at 1292.

is little reason to believe that a lawsuit intended to block an illegal bid would eliminate the bid sooner than the bidder's own realization that it was unable to sell the stock to another party at a premium or a suit brought by a regulatory agency to block the bid.[251]

The examples of low priced offers and illegal bids demonstrate that there are circumstances under which target directors might be able to benefit their stockholders by employing preclusive defenses. Nevertheless, target directors' potential to act in a self-interested way justifies courts in limiting target defenses to those which unambiguously promote stockholder choice. The proposed rule gives corporate directors an incentive to seek the highest available value for their stockholders in takeovers[252] and to manage their corporations as effectively as they are able to prevent hostile bids.[253]

V. CONCLUSION

The Delaware Supreme Court has gradually reduced the role of the business judgment rule as a tool for evaluating target defenses. Despite the Delaware court's repeated admonition that the business judgment rule applies in the tender offer context,[254] the court's decisions have demonstrated a grudging trend toward limiting target directors' discretion. *Cheff* required target directors to identify a threat justifying defensive tactics.[255] *Unocal* adopted a stricter standard, requiring target boards to demonstrate the proportionality of their defenses to perceived threats stemming from a hostile bid.[256] *Revlon* and *QVC* illustrate the logical extreme of the progression requiring the target directors in those cases to maximize value for their stockholders.[257]

Despite its trend toward limiting target boards' defensive actions, the Delaware Supreme Court has not made clear what circumstances trigger

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[251]Mr. Lipton's argument only justifies target defenses to the extent that employees, customers, and suppliers would hold the target responsible for failing to react to an illegal bid. *See supra* text accompanying note 243. Otherwise, the potential harms would occur, if at all, regardless of the directors' actions — the directors could not prevent the bid from being made in the first place. These nonstockholder constituents, however, would be unlikely to hold directors responsible for failing to sue a hostile bidder if courts precluded such defensive law suits.

[252]*See supra* notes 29-31, 205 and accompanying text.

[253]*See supra* notes 25-28, 214-17 and accompanying text.

[254]*See, e.g.*, Pogostin v. Rice, 480 A.2d 619, 627 (Del. 1984) ("In *Aronson*, 473 A.2d at 812-16, we discussed the availability, function and operation of the business judgment rule, including the standards by which director conduct is judged. What we said there is equally applicable here in the context of a takeover."); *Revlon*, 506 A.2d at 179-80.

[255]*Cheff*, 199 A.2d at 556.

[256]*Unocal*, 493 A.2d at 955.

[257]*See supra* notes 88-92, 152-62 and accompanying text.

target directors' duty to maximize stockholder value. Cases such as *Time* and *Ivanhoe* have interpreted *Revlon* narrowly.[258] Additionally, *QVC* specifically limited its adoption of directors' duty to maximize stockholder value to the facts of that case.[259] As in *Time*, the *QVC* court specified conditions which trigger this duty rather than attempting to formulate a broad rule.[260] *QVC* did not overrule *Time*, suggesting that the court may be willing to entertain justifications for target defenses based on long-term strategic plans or other grounds.

Courts should resolve the ambiguity regarding directors' duty to maximize stockholder value in response to hostile takeover bids by adopting the proposed rule. This approach would severely limit self-interested directors' strategic behavior. For instance, Delaware's current approach allows target directors to interpret the circumstances which trigger a duty to maximize stockholder value to their own advantage.[261] The proposed rule would preclude such behavior by requiring directors employing defenses which do not unambiguously promote their stockholders's ability to evaluate competing offers to maximize stockholder wealth in an auction. The

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[258]*See supra* notes 98-101, 118 and accompanying text.

[259]*QVC*, 637 A.2d at 51. In *QVC*, the court argued that the target board had unintentionally initiated an auction "by agreeing to sell control of the corporation to Viacom in circumstances where another potential acquiror (QVC) was equally [as] interested in being a bidder." *Id.* at 47. The court did not adequately explain why this triggering condition was not satisfied on the facts of *Time*, however, where Paramount was a "potential acquiror . . . [as] equally interested in being a bidder" as Warner. *See* Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990). The Delaware Supreme Court should refuse to accept target directors' subjective interpretation of when their corporation is for sale, see *supra* notes 96-99, 101, 111-13, 157-58 and accompanying text, in keeping with *QVC*'s reasoning that an undesired bid can trigger an auction.

[260]*QVC*, 637 A.2d at 47-48. *QVC*'s interpretation of *Revlon* was clearly broader than *Time*'s, however. *See supra* notes 164-82 and accompanying text.

[261]Delaware's specification of circumstances which trigger the duty to maximize stockholder value is problematic. The defense which results from *QVC*'s change of control analysis, see *supra* notes 164-65 and accompanying text, demonstrates an extreme case of this problem. More generally, target directors will almost certainly try to characterize transactions they are involved in as outside of the triggering circumstances. *E.g.*, *QVC*, 637 A.2d at 47-48 (rejecting Paramount's argument that both an inevitable sale and break up of the target are prerequisites for *Revlon* to apply).

The proposed approach would resolve additional doctrinal problems. Courts could avoid the difficulties associated with determining what constitutes a proportionate response to threats identified by target directors, whether real or contrived, by limiting directors' discretion to specified actions which unambiguously enhance stockholder choice. Similarly, this approach would resolve courts' current difficulty in determining whether the duty of loyalty or duty of care is applicable in the tender offer context. *See* Seligman, *supra* note 1, at 10-22 (discussing the current ambiguity and arguing that a duty of loyalty analysis is appropriate). The proposed stockholder choice paradigm focuses on the intent, rather than the form, of directors' fiduciary duties in tender offers. *See supra* notes 32-35 and accompanying text.

proposed approach would also facilitate corporate planning by giving directors a clear signal regarding their appropriate role in response to a tender offer. Along with simplifying courts' task in evaluating tender offer defenses, this approach would go far towards aligning target directors' incentives with their stockholders' interests.