Note

WHEN DELAWARE CORPORATE MANAGERS TURN AUCTIONEERS: TRIGGERING THE *REVLON* DUTY AFTER THE *PARAMOUNT* DECISION

I. INTRODUCTION

In its landmark decision, *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*,[1] the Delaware Supreme Court held that when the "sale" and "break-up"[2] of a corporation become inevitable, the role of the board of directors changes from "defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."[3] In addition to challenging

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1. 506 A.2d 173 (Del. 1986).

2. A "break-up" or "bust-up" takeover refers to an acquisition financed by selling the component parts of the acquired company. The assumption is that the sum of the parts will be greater in value than the whole. *See* Moran v. Household Int'l, Inc., 500 A.2d 1346, 1349 n.4 (Del. 1985); R. HAMILTON, CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED PARTNERSHIPS 816 (3d ed. 1986). A "bust-up" sale commonly follows a leveraged buyout or other forms of acquisition financed by "junk bonds." Lipton & Brownstein, *Takeover Responses and Directors' Responsibilities—An Update*, 40 BUS. LAW. 1403, 1411-12 (1985).

3. *Revlon*, 506 A.2d at 182. Delaware case law supports the requirement that a board of directors seek the highest price obtainable when selling corporate assets. *See, e.g.*, Wilmington Trust Co. v. Coulter, 200 A.2d 441 (Del. 1964) (corporate trustee is required to obtain the best price available for corporate assets in light of overriding consideration of safety of trust assets); Thomas v. Kempner, 398 A.2d 320, 323 (Del. Ch. 1973) (fiduciary faced with two competing bids for an asset must accept higher bid); Lockwood v. OFB Corp., 305 A.2d 636, 639 (Del. Ch. 1973) (trustees appointed by chancery court for dissolved corporation must attempt to assure sale of corporate asset at the best price available by engaging in "a reasonably aggressive program"); Robinson v. Pittsburgh Oil Ref. Corp., 126 A. 46, 49 (Del. Ch. 1924) (directors selling corporation's assets at direction of stockholders presumed to act in good faith for best interests of the corporation). *Contra* Abelow v. Midstates Oil Corp., 189 A.2d 675, 678-79 (Del. 1963) (rejecting as "pure speculation" the argument that the directors "should have solicited other offers, which might have been higher" in undertaking to sell the corporation's assets); Bowling v. Bonneville, Ltd., No. 1688, slip op. at 7 (Del. Ch. Jan. 14, 1963), *reprinted in* 2 DEL. J. CORP. L. 162, 168-69 (1982) (directors' "duty to obtain the best offer . . . does not require that the assets be placed upon the auction block"); Simkins Indus. v. Fibreboard Corp., No. 5369, slip op. at 2 (Del. Ch. July 28, 1977), *reprinted in* 3 DEL. J. CORP. L. 144, 145 (1983) (rejecting plaintiff's

traditional notions of corporate governance, *Revlon* generated concern about the ability of corporate directors to defend the corporate entity and to pursue long-term strategy for corporate profitability when in a takeover context.[4] Once *Revlon* is triggered, corporate directors must abandon their long-term profit-making strategy for the corporate enterprise and instead maximize the current value of the shareholders' stock.[5] This is the "*Revlon* duty."[6]

For a corporate board of directors that wishes to sell the company, the *Revlon* opinion directs how the sale must proceed.[7] But

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contention "that defendant be required by this Court to conduct its proposed sale of its carton producing assets as if defendant were a government agency, namely on the basis of sealed bids or by Court regulated competitive bidding"), *quoted in* Lamb & Turezyn, Revlon *and* Hanson Trust: *Unlocking the Lock-Ups*, 12 DEL. J. CORP. L. 497, 500 n.14 (1987).

4. *See* Bogen, *Corporate Governance in Takeover and Buyout Transactions: Selected Recent Developments*, *reprinted in* 2 ACQUISITIONS & MERGERS 1989, at 572 (Practising Law Institute 1989) ("[T]he *Revlon* opinion . . . contains language suggesting radical restraints on the latitude of any target directors in a takeover."). *See infra* text and accompanying notes 87-101.

5. *Revlon*, 506 A.2d at 182.

6. For purposes of this note, the "*Revlon* duty" refers to the single obligation of a board of directors to maximize current shareholder value. This duty encompasses additional obligations and responsibilities and therefore is often pluralized as "*Revlon* duties." Because this note will not address the method by which board directors must maximize current shareholder value, the note will refer only to the "*Revlon* duty."

The *Revlon* duty is often referred to as the "*Revlon* mode," describing "that situation in which *Revlon* duties arise." TW Servs., Inc. v. SWT Acquisition Corp., Nos. 10,427 & 10,298 (consolidated), slip op. at 21 (Del. Ch. Mar. 2, 1989), *reprinted in* 14 DEL. J. CORP. L. 1169, 1184-85 (1989). However, the Delaware Supreme Court has not adopted this expression.

7. *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). *See, e.g.*, Black & Decker Corp. v. American Standard Inc., 682 F. Supp. 772 (D. Del. 1988); Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53 (Del. 1989); Barken v. Amsted Indus., Inc., 567 A.2d 1279 (Del. 1989); Mills Acquisition Co. v. MacMillan Inc., 559 A.2d 1261 (Del. 1989); *In re* Holly Farms Corp. Shareholders Litig., No. 10,350 (Del. Ch. Dec. 30, 1988), *reprinted in* 14 DEL. J. CORP. L. 1062 (1989)); TW Servs., Inc. v. SWT Acquisition Corp., Nos. 10,427 & 10,298 (consolidated) (Del. Ch. Mar. 2, 1989), *reprinted in* 14 DEL. J. CORP. L. 1169 (1989); *In re* RJR Nabisco, Inc. Shareholders Litig., No. 10,389 (Del. Ch. Jan. 31, 1989), *reprinted in* 14 DEL. J. CORP. L. 1132 (1989); Robert M. Bass Group, Inc. v. Evans (MacMillan I), 552 A.2d 1227 (Del. Ch. 1988); *In re* J.P. Stevens & Co. Shareholders Litig., 542 A.2d 770 (Del. Ch. 1988); *In re* Fort Howard Corp. Shareholders Litig., No. 9991 (Del. Ch. Aug. 8, 1988), *reprinted in* 14 DEL. J. CORP. L. 699 (1989); Yanow v. Scientific Leasing, Inc., Nos. 9536 & 9561 (Del. Ch. Feb. 5, 1988) (revised Feb. 8, 1988), *reprinted in* 13 DEL. J. CORP. L. 1273 (1988); Freedman v. Restaurant Assocs. Indus., Inc., No. 9212 (Del. Ch. Oct. 16, 1987), *reprinted in* 13 DEL. J. CORP. L. 651 (1988). *See generally* Nachbar,

for a corporate board that has no desire to sell the company, the *Revlon* opinion is unsettling for it implies that a board might involuntarily "find itself" obligated to conform with the *Revlon* duty as a result of its own transactions or the determination of a hopeful acquiror.[8]

The broad and ambiguous language of *Revlon* left subsequent courts with the task of articulating the circumstances under which a corporate board of directors would be charged with the *Revlon* duty.[9] Perhaps because of the inherent difficulty in determining when the "break-up" of a corporation becomes inevitable, most courts construing *Revlon* narrowed their inquiry to whether or not a "sale" of corporate control was inevitable.[10] In *Ivanhoe Partners, Inc. v. Newmont Mining Corp.*,[11] the Delaware Supreme Court, construing *Revlon* for the first time, concluded that the *Revlon* duty will trigger only where an absolute majority voting block of a company will be sold.[12] This *sale of corporate control* test was expanded in *Mills Acquisition Co. v. MacMillan, Inc.*,[13] in which the Delaware Supreme Court indicated that the *Revlon* duty will trigger *absent* a formal sale where a corporate transaction—be it a bidding contest, a buyout, or a restructuring[14]—*transfers* corporate control.[15]

These cases left unresolved the implication in *Revlon* that a hopeful acquiror can cause the sale and break-up of its target[16] and thereby charge the target board with the *Revlon* duty.[17] In its most recent discussion of the *Revlon* duty, *Paramount Communications, Inc.*

Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.—*The Requirement of a Level Playing Field in Contested Mergers, and its Effect on Lock-Ups and Other Bidding Deterrents*, 12 DEL. J. CORP. L. 473 (1987) (discussing the significance of the *Revlon* decision to contested merger transactions with particular emphasis on lock-up options).

8. *See infra* text accompanying notes 86-91.

9. *Id.*

10. *See infra* note 101.

11. 535 A.2d 1334 (Del. 1987).

12. *Id.* at 1345.

13. 559 A.2d 1261 (Del. 1989).

14. *Id.* at 1285.

15. *See infra* text accompanying notes 172.

16. A "target" corporation refers to a company which is the potential victim of a "raider." When an acquisition is attempted without the consent of the corporate management, the potential acquiror is referred to as a "raider." A raider is the pejorative term for bidder. J. HOGG, THE PREDATOR AND THE PREDATEE 1 n.1 (1988).

17. *See infra* note 89 and accompanying text.

v. Time Inc.,[18] the Delaware Supreme Court has strongly suggested that a hopeful acquiror cannot force its target to assume the *Revlon* duty. Rather, in ascertaining whether or not a corporate board is charged with the *Revlon* duty, a reviewing court should determine whether there is substantial evidence to conclude that the target board has acted in a way that makes the *break-up* of the corporate entity inevitable.[19]

Paramount reveals the court's policy against corporate break-ups. This was arguably a message the court intended to convey in *Revlon*,[20] but which was avoided for practical reasons by courts construing *Revlon*.[21] Hence, the *Paramount* opinion may undermine the significance of a mere *sale* or *transfer of corporate control* in triggering the *Revlon* duty.

This note will examine Delaware Supreme Court cases considered pivotal in understanding when the *Revlon* duty arises and will conclude with an evaluation of the policies underlying the court's most recent pronouncement in *Paramount*.

II. BACKGROUND

A. *Corporate Governance: Where* Revlon *Fits In*

Under Delaware corporate law the board of directors is responsible for managing the business and affairs of the corporation to maximize the long-run interests of shareholders.[22] The board's

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18. 571 A.2d 1140 (Del. 1990).

19. *Id.* at 1150. *See infra* text accompanying notes 217-19.

20. Coffee, *Shareholders Versus Management, The Strain in the Corporate Web*, 85 MICH. L. REV. 1, 4 n.4 (1986) ("Courts have . . . recognized the special nature of the bust-up takeover and hinted that they may justify defensive tactics not otherwise appropriate.") (discussing *Revlon*).

21. *See* Reder, *The Obligation of a Director of a Delaware Corporation to Act as an Auctioneer*, 44 BUS. LAW. 275, 275 (1989).

> [I]n *Revlon* . . . the Delaware Supreme Court articulated its view that the duties of a director considering a takeover offer may differ significantly if the transaction contemplates breaking up the target rather than continuing its corporate effectiveness. However, this term, "break-up[,]" has been either ignored or misconstrued, possibly because it is exceedingly difficult to create a test to carry out the court's apparent policy goal.

Id. See infra text accompanying notes 93-101.

22. Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984). *See* DEL. CODE ANN. tit. 8, § 141(a) (Michie Supp. 1988) ("The business and affairs of every corporation organized under this chapter shall be managed by or under direction of a board

authority to act derives from its fundamental duty to protect the corporate entity from harm.[23] In pursuing this role, corporate directors owe fiduciary duties of care[24] and loyalty[25] to both the corporation and its shareholders.[26] The board of directors is elected by the owners of the corporation, the shareholders,[27] to develop and carry out a profit-making strategy for the corporation.

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of directors . . . .''). *See also Paramount*, 571 A.2d at 1150 (A board of directors' "broad mandate includes a conferred authority to set a corporate course of action, including a time frame, designed to enhance corporate profitability."); *TW Servs.*, Nos. 10,427 & 10,298 (consolidated), slip op. at 21, *reprinted in* 14 DEL. J. CORP. L. at 1183 ("[D]irectors may be said to owe a duty to shareholders as a class to manage the corporation . . . in a way intended to maximize the *long run* interests of shareholders.") (emphasis added).

23. *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 953 (Del. 1985); Kaplan v. Goldsamt, 380 A.2d 556, 568-69 (Del. 1977); Cheff v. Mathes, 199 A.2d 548, 556 (Del. 1964).

24. "The directors' duty to exercise an informed business judgment is in the nature of a duty of care, [as] distinguished from a duty of loyalty." Smith v. Van Gorkom, 488 A.2d 858, 872-73 (Del. 1985). To satisfy this fiduciary duty of care, directors must "inform themselves, prior to making a business decision, of all material information reasonably available to them." *Aronson*, 473 A.2d at 812.

25. Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939). *Guth* defines this fiduciary duty of loyalty as follows:

> Corporate officers and directors are not permitted to use their position of trust and confidence to further their private interests. While technically not trustees, they stand in a fiduciary relation to the corporation and its stockholders. A public policy, existing through the years, and derived from a profound knowledge of human characteristics and motives, has established a rule that demands of a corporate officer or director, peremptorily and inexorably, the most scrupulous observance of his duty, not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to deprive it of profit or advantage which his skill and ability might properly bring to it, or to enable it to make in the reasonable and lawful exercise of its powers.

There are two types of loyalty owed by board directors: (1) primary loyalty to the corporation and its shareholders (other constituencies may be considered in the decision-making process only to the extent that they benefit the corporate entity and the shareholders), and (2) the duty to avoid self-interest. Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).

26. *Aronson*, 473 A.2d at 812; *Guth*, 5 A.2d at 510.

27. DEL. CODE ANN. tit. 8, § 211(b) (Michie 1983) ("An annual meeting of stockholders shall be held for the election of directors on a date and at a time designated by or in the manner provided in the by-laws."). *Id.* § 141(k) ("Any director or the entire board of directors may be removed, with or without cause, by the holders of a majority of the shares then entitled to vote at an election of directors . . . .").

Delaware law confers broad authority upon a board to pursue such long-term strategies.[28] For example, courts have recognized the right of directors to promote the profit-making interests of long-term investors at the expense of short-term investors.[29] They have also protected decisions of the board concerning matters of financing and investment of corporate assets by applying the "business judgment rule."[30] Under this rule, a business decision is presumed by the court to have been made on an "informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[31] The underlying policy of the business judgment

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28. *See Unocal*, 493 A.2d at 953 ("The board has a large reservoir of authority upon which to draw."); R. BALOTTI & J. FINKELSTEIN, THE DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS § 4.6, at 72 (rev. perm. ed. 1989) ("To facilitate the directors' decision[-]making process, there has developed in the courts a policy of affording substantial deference to the business decisions made by corporate directors.") (citing, e.g., Aronson v. Lewis, 473 A.2d 805 (Del. 1984); Zapata Corp. v. Maldonado, 430 A.2d 779 (Del. 1981); Sinclair Oil Corp. v. Levien, 280 A.2d 717 (Del. 1971)).

29. *See TW Servs.*, Nos. 10,427 & 10,298 (consolidated), slip op. at 18, *reprinted in* 14 DEL. J. CORP. L. at 1183:

> [T]he interests of the shareholders as a class are seen as congruent with those of the corporation in the long run; that directors, in managing the business and affairs of the corporation, may find it prudent (and are authorized) to make decisions that are expected to promote corporate (and shareholder) long run interests, even if short run share value can be expected to be negatively affected . . . .

Id. See also Jonas, *Who is the Client?: The Corporate Lawyers' Dilemma*, 39 HASTINGS L.J. 617 (1988) (discussing the conflict between shareholders', short-term interest and long-term goals of the corporate entity). *But see* Note, *Shareholder Rights Plans—Do They Render Shareholders Defenseless Against Their Own Management?*, 12 DEL. J. CORP. L. 991 (1987). Shareholders may protect their own interests by exercising their statutory rights under Delaware law: (DEL. CODE ANN. tit. 8, § 242 (Michie 1983)) (a) (to amend the articles of incorporation); DEL. CODE ANN. tit. 8, § 251 (Michie Supp. 1988) (b) (to approve certain mergers and consolidations); *id.* § 271 (c) (to approve the sale of substantially all assets); *id.* § 275 and (d) (to approve dissolutions).

30. *Aronson*, 473 A.2d at 812. The business judgment rule codifies the fundamental principle of DEL. CODE ANN. tit. 8, § 141(a) (Michie Supp. 1988), that the business and affairs of a corporation are managed by its board of directors. *See* Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984); *Zapata*, 430 A.2d at 782; *Cheff*, 199 A.2d at 554; Bodell v. General Gas & Elec. Corp., 140 A. 264, 267 (Del. 1927). *See generally* Wander & LeCoque, *Boardroom Jitters: Corporate Control Transactions and Today's Business Judgment Rule*, 42 BUS. LAW. 29 (1989) (review of business judgment rule with an analysis of its application to various board decisions); Pease, Aronson v. Lewis: *When Demand Is Excused & Delaware's Business Judgment Rule*, 9 DEL. J. CORP. L. 62 (1984).

31. *Aronson*, 473 A.2d at 812. *See, e.g.*, *Van Gorkom*, 488 A.2d at 872. Where the business judgment rule applies,

rule is that a corporate board of directors is better equipped to understand the nature of its transactions than is the judiciary.[32] The court, therefore, will defer to managerial expertise where the board's decision can be "attributed to any rational business purpose."[33]

In the context of a takeover,[34] the board of directors for the target company has a duty to determine whether an offer is in the

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> the plaintiff must establish either bad faith (i.e., whether the directors were motivated by other than an honest desire to benefit the corporation and its stockholders in approving the transaction) or lack of due care (i.e., whether the directors failed to make a reasonable effort to ascertain and consider all relevant information).

Id. BALOTTI & FINKELSTEIN, *supra* note 28, at 80. The business judgment rule requires the presence of five factors: a business decision, disinterestedness, due care, good faith, and no abuse of discretion. D. BLOCK, N. BARTON & S. RADIN, THE BUSINESS JUDGMENT RULE: FIDUCIARY DUTIES OF CORPORATE DIRECTORS AND OFFICERS 3 (1987).

32. *See* Beard v. Elster, 39 Del. Ch. 153, 165, 160 A.2d 731, 738-39 (1960) ("We are precluded from substituting our uninformed opinion for that of experienced business managers of a corporation who have no personal interest in the outcome and whose sole interest is the furtherance of the corporate enterprise.").

33. *Sinclair Oil Corp.*, 280 A.2d at 720. Corporate directors should be given discretion to develop business strategies that may enhance the company's effectiveness and profitability in response to complex and rapidly changing market forces. Note, *Tender Offer Defensive Tactics and the Business Judgment Rule*, 58 N.Y.U. L. REV. 621, 650-51 (1983). Judicial oversight into director decision-making may undermine director discretion, thereby discouraging directors from pursuing desirable business risks. Comment, *The Misapplication of the Business Judgment Rule in Contests for Corporate Control*, 76 NW. U.L. REV. 980, 983-84 (1982). *See also* Reading Co. v. Trailer Train Co., No. 7422, slip op. at 10 (Del. Ch. Mar. 15, 1984), *reprinted in* 9 DEL. J. CORP. L. 223, 229 (1984):

> The business judgment rule allows for the possibility that other people might disagree with a board's decision. Indeed it is acknowledged that a board's decision, otherwise properly based could be wrong and still withstand attack . . . . In the context of our corporate business world, courts should be loathe to interfere with the internal management of corporations or to interfere with their business decisions unless statutory or case law indicates they have overstepped their bounds.

Id.

34. A takeover attempt is:

> an attempt by a bidder ("raider") to acquire control of a subject company ("target") through acquisition of some or all of its outstanding shares. Most commonly, takeover bids are made directly to shareholders of the target as a cash tender offer or as an exchange offer of raider securities for target stock. . . .
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> The principal takeover approaches include a "friendly" transaction negotiated with management; a "bear hug," in which the raider notifies the target of a proposed acquisition transaction; a "hostile" offer made directly to target shareholders, without management approval; and, as a supplement or alternative to these approaches, large open market and/or

best interests of the corporation and its shareholders.[35] The board may determine that preserving the corporation's independence would best serve the board's long-term business planning.[36] Such a determination would lead to the adoption of a defensive measure to fend off the acquiring corporation. The decision to defend differs from a normal operational business decision because of the "omnipresent specter" that board directors will act out of a desire to perpetuate themselves in office, rather than in the best interests of the corporation and the shareholders.[37] This potential conflict requires that the adoption of a defensive measure pass muster under a two-prong test, articulated in *Unocal Corp. v. Mesa Petroleum Co.*,[38] before the board will receive protection from the business judgment rule.

Pursuant to *Unocal*, a board of directors has the burden of demonstrating that it had "reasonable grounds for believing there was a danger to corporate policy and effectiveness" from the takeover attempt.[39] In addition to this, the board must also establish that the defensive measure taken was "reasonable in relation to the threat

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privately negotiated purchases of target stock.

Note, *Corporate Auctions and Directors' Fiduciary Duties: A Third-Generation Business Judgment Rule*, 87 MICH. L. REV. 276, 276 (1988).

35. *Unocal*, 493 A.2d at 954.

36. *TW Servs.*, Nos. 10,427 & 10,298 (consolidated), slip op. at 17, *reprinted in* 14 DEL. J. CORP. L. at 1182. *See also Paramount*, 571 A.2d at 1154 ("Directors are not obligated to abandon a deliberately conceived corporate plan for short-term shareholder profit unless there is clearly no basis to sustain corporate strategy."); *Unocal*, 493 A.2d at 958 (while a board of directors owes the duties of care and loyalty to shareholders, in the face of a destructive threat to the company the board has a supervening duty to protect the corporate enterprise). *See infra* text and accompanying notes 214-15, 236-51.

37. *Unocal*, 493 A.2d at 954. The business judgment rule will not be applied if the business decision is shown to have been motivated primarily by self-interest on the part of the directors. *See, e.g.*, Fleigler v. Lawrence, 361 A.2d 218, 221 (Del. 1976); *Sinclair Oil*, 280 A.2d at 720; Bennet v. Propp, 187 A.2d 405, 409 (Del. 1962) (stating that a threat to corporate control necessarily involves a conflict of interest, requiring directors to prove their actions primarily favored the corporation's interest). *See generally* Block & Miller, *The Responsibilities and Obligations of Corporate Directors in Takeover Contests*, 11 SEC. REG. L.J. 44, 49 (1983) (discussing the conflict of interest inherent in board decisions directed at takeover attempts).

38. 493 A.2d 946 (Del. 1985).

39. *Id.* at 955. This burden is satisfied by showing "good faith and reasonable investigation." *Id.* (quoting *Cheff*, 199 A.2d at 554-55). The burden is met more easily if the decision was approved by "a board comprised of a majority of outside independent directors . . . ." *Id. See Aronson*, 473 A.2d at 815; Puma v. Marriot, 283 A.2d 693, 695 (Del. Ch. 1971).

posed."[40] Satisfaction of these two elements will lead to the application of the business judgment presumption to the board's decision.[41] If a decision by the board fails under the *Unocal* test, the court will "substitute its own judgment for that of the board."[42]

The role of a corporate board of directors shifts dramatically when the board assumes the *Revlon* duty: when a corporation is to be sold and broken up, there will be no corporate policy and long-term strategy to protect.[43] There is only one role remaining for the board of directors, and that is to maximize the current value of the company for the benefit of its shareholders.[44]

Board decisions made while under the *Revlon* duty are afforded the protection of the business judgment rule, unless a showing has been made that bidders in the corporate auction were treated on unequal terms.[45] If unequal treatment is shown, directors must prove that they "properly perceived that shareholder interests were enhanced," and that their actions were "reasonable in relation to the advantage sought to be achieved, or conversely, to the threat which a particular bid allegedly poses to stockholder interests."[46]

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40. *Unocal*, 493 A.2d at 955. In evaluating whether the defensive measure was reasonable in relation to the threat posed, management is free to consider the "inadequacy of the price offered, [the] nature and timing of the offer, questions of illegality, the impact on constituencies other than shareholders, the risk of nonconsummation, and the quality of [the] securities being offered in the exchange." *Id.* The precise showing necessary to prove a business decision "reasonable in relation to the threat posed" has yet to be determined by the courts. Presumably directors will prove the "reasonable" nature of the action by demonstrating that their action was "based on an anaylsis [sic] of the perceived danger and its effect on the corporation and the shareholders." BALOTTI & FINKELSTEIN, *supra* note 28, at 86 (quoting Polk v. Good, 507 A.2d 531, 537 (Del. 1986)).

41. *Pogostin*, 480 A.2d at 627. *See Moran*, 500 A.2d at 1350; Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

42. [U]nless it is shown by a preponderance of the evidence that the directors' decisions were primarily based on perpetuating themselves in office or some other breach of fiduciary duty such as fraud, overreaching, lack of good faith, or being uninformed, a Court will not substitute its judgment for that of the board.

Unocal, 493 A.2d at 958.

43. *Revlon*, 506 A.2d at 182.

44. *Id.* The directors' role during a corporate auction "remains an active one." *Id.* at 184. *See* cases cited *supra* note 7.

45. Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1286-87 (Del. 1989).

46. *Id.* at 1288 (citing *Unocal*, 493 A.2d at 955).

B. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.

1. Facts and Holding

The *Revlon* decision grew out of Pantry Pride Enterprise's (Pantry Pride)[47] unremitting effort to acquire Revlon, the cosmetics giant.[48] Pantry Pride's attempts to negotiate a merger with Revlon in the range of $40-$50 per share, beginning in June of 1985, were rejected by Revlon directors for being below Revlon's intrinsic value.[49] When Pantry Pride threatened with a hostile tender offer[50] for $45 per share, Revlon directors reacted by adopting both a Note Purchase Rights Plan (Rights Plan)[51] and a stock repurchase

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47. The nominal plaintiff, MacAndrews & Forbes Holdings, Inc., was the controlling stockholder of Pantry Pride.

48. *Revlon*, 506 A.2d at 175.

49. *Id.* at 176.

50. A "tender offer" is "a bid by an individual or group to buy shares of a company—usually at a price above the current market price. Those accepting the offer are said to tender their stock for purchase. The person making the offer obligates himself to purchase all or a specified portion of the tendered shares if certain specified conditions are met." Austin, Nigem & Bernard, *Tender Offer Update: 1987*, Mergers & Acquistions, July-Aug. 1987, at 49, 49-50.

51. *Revlon*, 506 A.2d at 177.

A Note Purchase Rights Plan is a form of a "poison pill," a device designed to discourage hostile takeovers by making the target company prohibitively more expensive and thus less desirable to the bidder. A corporation distributes to its shareholders a class of securities as preferred stock, or "rights." Typically, these rights are automatically converted into the voting stock of the surviving entity if an acquiror obtains a specified percentage of the target's shares. If the acquiror holding the specified percentage fails to consummate a second step merger within a specified period of time, the holders of the rights may elect to have their stock redeemed by the target at a price equal to the highest price paid by the acquiror. In addition, the poison pill rights have redemption and conversion privileges becoming exercisable and traded independently from the common shares upon specified triggering events. If the acquiror attains control in the target company, each poison pill right permits its holder to purchase common stock in the acquiring corporation at terms favorable to the holder and significantly dilutive to the acquiror. Poison pill rights are redeemable by a target's board of directors so that friendly acquisitions may proceed. Note, *Poison Pill Rights: Toward a Two-Step Analysis of Directors' Fidelity to Their Fiduciary Duties*, 56 GEO. WASH. L. REV. 373, 374-75 (1988).

The Delaware Supreme Court upheld the validity of the poison pill in *Moran*, 500 A.2d at 1351, under section 157 of the Delaware General Corporation Law, which authorizes transactions in a corporation's stock.

The Revlon Rights Plan would give Revlon shareholders as a dividend one Note Purchase Right (the Rights) for each share of common stock. The Rights entitled the holder to exchange one common share for a $65 principal Revlon note

plan,[52] in August 1985.

Revlon offered to purchase up to ten million shares (26%) of its own common stock in exchange for newly issued notes worth $47.50 and preferred stock valued at $100 per share.[53] The notes made consummation of a takeover difficult. They contained restrictive covenants limiting Revlon's ability to incur additional debt, sell assets, and pay dividends.[54]

Pantry Pride, which had initially commenced a hostile tender offer for any and all Revlon shares at $47.50 per common share, lowered its tender offer bid to $42.[55] Revlon directors rejected Pantry Pride's offer, and on September 24, 1985, authorized Revlon management to negotiate with other parties interested in acquiring Revlon.[56]

On October 3, 1985, Revlon directors approved a leveraged buyout[57]

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at 12% interest with a one-year maturity. The Rights would be triggered whenever anyone acquired 20% or more of Revlon shares, unless the purchaser acquired all the company's stock for cash at $65 or more per share. The Rights, redeemable by the Revlon Board before the triggering event, would not be available to the acquiror. *Revlon*, 506 A.2d at 177.

52. *Revlon*, 506 A.2d at 177. In a stock repurchase plan, otherwise referred to as an "exchange offer," the target company offers to purchase its own shares, typically at a higher price than the bidder is offering, so that target shareholders are less likely to tender to the bidder. *See* DEL. CODE ANN. tit. 8, § 160(a) (Michie 1983) (providing in relevant part that "[e]very corporation may purchase, redeem, receive, take or otherwise acquire, own and hold, sell, lend, exchange, transfer or otherwise dispose of, pledge, use and otherwise deal in and with its own shares").

53. *Revlon*, 506 A.2d at 177. Each share of common stock tendered would be exchanged for one Senior Subordinated Note of $47.50 principal at 11.75% interest, due 1995, and one-tenth of a share of $9 Cumulative Convertible Exchangeable Preferred Stock valued at $100 per share. By September 13, 1985, Revlon stockholders had tendered 87% of the outstanding shares. *Id.*

54. *Id.*

55. *Id.* Pantry Pride's initial offer was made August 23, 1985, for $47.50 per common share and $26.67 per preferred share. This offer was contingent upon Pantry Pride's obtaining financing and upon the redemption of Revlon's Rights. Pantry Pride reduced its offering price to $42 per common share on September 16, 1985, conditioned upon receiving at least 90% of Revlon's outstanding stock. *Id.*

56. *Id.*

57. A leveraged buyout has been defined by one noted commentator as an:

> [a]cquisition of a business in a transaction where the purchaser's equity risk is small in relation to the purchase price and most of the purchase price is provided by borrowings from one or more outside lenders and, in some transactions, in part from the seller in the form of deferred purchase price. The lenders look to the assets and/or the cash flow of the acquired business itself as the source of repayment of the loans, rather

with a "white knight,"[58] Forstmann Little & Co. (Forstmann), for $56 in cash per share.[59] Revlon management would remain an equity participant in the new company by purchasing stock with the proceeds from Revlon's "golden parachutes."[60] Forstmann agreed to assume the large debt incurred by Revlon in issuing the notes.[61] In exchange, Revlon directors would redeem the rights and waive the notes' covenants for Forstmann.[62] Finally, the buyout would be financed by selling three of Revlon's divisions. Prior to the merger Revlon would sell its Beauty Products division to Adler & Shaykin for $905 million.[63] After the merger Forstmann would sell Revlon's Norcliff Thayer and Reheis divisions to American Home Products for $335 million.[64]

When the Forstmann merger and the waiver of the notes' covenants were publicly announced, the market value of the notes began to drop.[65] The noteholders threatened to sue Revlon directors, and

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> than looking to the purchaser, who generally has no legal commitment to invest funds beyond the initial investment.

Benjamin, *Leveraged Acquisitions*, in LEVERAGED ACQUISITIONS AND BUYOUTS 1988, at 9, 11 (Practising Law Institute 1988), *reprinted in* Note, *An Examination of a Board of Directors' Duty to Redeem the Rights Issued Pursuant to a Stockholder Rights Plan*, 14 DEL. J. CORP. L. 537, 548 n.64 (1989).

58. A white knight is a third party willing to make a competing bid that will, it is hoped, be more attractive to shareholders and kinder to target management. Prentice & Langmore, *Hostile Tender Offers and the "Nancy Reagan Defense": May Target Boards "Just Say No"?*, 15 DEL. J. CORP. L. 377, 379 (1990) (citing Quinn, *How to Avoid Unwanted Takeovers*, Corp. L. Guide (CCH) para. 26,061, at 26,388 (1981)).

59. *Revlon*, 506 A.2d at 178.

60. "Golden parachutes" are "lucrative employment and fringe benefit contracts given to top management in target corporations. The purposes of such contracts may be to assure the continued loyalty of management . . . and increase the cost of a successful takeover by increasing the costs chargeable to the target corporation after it is taken over." HAMILTON, *supra* note 2, at 815-16. Often a manager's right to receive the special termination compensation specified in the "golden parachute" clause of his employment contract is triggered by a "change in control" of the corporation such that the manager need not be terminated by the successful bidder but may voluntarily resign and collect the specified payment. Coffee, *supra* note 20, at 77 n.211.

61. *Revlon*, 506 A.2d at 178.

62. *Id.* The Revlon Board favored Forstmann over Pantry Pride throughout the bidding contest. The board provided Forstmann with access to confidential financial data at the exclusion of Pantry Pride, and granted him private meetings with Revlon advisors, among other advantages. The court held that unfair treatment of bidders during a corporate auction is a breach of directors' fiduciary duties. *Id.* at 184. *See also* cases cited *supra* note 7 (providing information on how corporate auctions must proceed).

63. *Revlon*, 506 A.2d at 178.

64. *Id.*

65. *Id.* By October 8, the notes, which originally traded around $100, dropped to $87.50.

as a result the directors became concerned with restoring the value of the-notes.[66]

Pantry Pride raised its conditional offer from $53 to $56.25, and on October 9, 1985, announced that it would engage in fractional bidding to top any subsequent Forstmann offer.[67]

Forstmann responded by increasing its offer to $57.25 cash per share,[68] contingent upon receiving from Revlon directors the following provisions: an asset "lock-up" option[69] to purchase Revlon's Vision Care and National Health Laboratories divisions[70] if another acquiror obtained 40% of Revlon's shares; a "no-shop" clause;[71] removal of the poison pill rights and the notes' covenants; a large cancellation fee;[72] and in contrast to the original agreement Forstmann now required that there be no participation by Revlon management in the merger. In return for these conditions Forstmann would support the par value of the notes. Forstmann demanded immediate acceptance of its offer.[73]

The Revlon Board approved Forstmann's offer on several grounds. First, its $57.25 bid represented a higher offer than Pantry Pride's $56.25 bid.[74] Forstmann's promise to support the declining

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66. *Id.* at 179.

67. *Id.* at 178.

68. *Id.*

69. A "lock-up" option is a "transaction by which the target corporation in a contested takeover gives one proposed acquirer a competitive advantage over other bidders [by] granting the favored suitor (the 'white knight') an option to buy shares or assets of the target." Note, *Lock-up Options: Toward a State Law Standard*, 96 HARV. L. REV. 1068, 1068 (1983).

70. Forstmann's proposal contemplated a price of $525 million for both of these Revlon divisions, some $100-$175 million below their value as estimated by Revlon's investment banker. *Revlon*, 506 A.2d at 178.

71. A "no-shop" clause is a provision in the acquisition agreement in which the target board agrees not to attempt to sell the company to other bidders. "Typical no-shop provisions prohibit the board, management, and their advisors from soliciting, discussing or encouraging an acquisition proposal with anyone else." Herzel & Shepro, *Negotiated Acquisitions: The Impact of Competition in the United States*, 44 BUS. LAW. 301, 307, 308 (1989).

72. Cancellation or "break-up" fees are "concessions extracted by aggressive [but] friendly bidders [consisting] of an agreement to make payments to the purchaser in a negotiated acquisition if the acquisition fails because of a higher competing bid." *Id.* at 311.

Forstmann's proposal called for "a $25 million cancellation fee to be placed in escrow, and released to Forstmann if the new agreement terminated or if another buyer acquired more than 19.9% of Revlon's stock." *Revlon*, 506 A.2d at 178.

73. *Revlon*, 506 A.2d at 178-79.

74. The court noted that "Forstmann's $57.25 offer ostensibly is worth $1 more than Pantry Pride's $56.25 bid. However, the Pantry Pride offer was im-

notes protected the interest of noteholders, a primary concern of the board.[75] Finally, Forstmann's financing was firmly in place.[76] The board agreed to redeem the Rights Plan for Forstmann.[77]

Pantry Pride once again raised its bid, this time to $58 per share,[78] and filed suit in the Delaware Court of Chancery to enjoin the asset lock-up, no-shop and cancellation fee provisions of the Revlon-Forstmann agreement.

The Delaware Court of Chancery granted Pantry Pride's motion for a preliminarily injunction.[79] The court held that the Revlon directors had breached their duty of loyalty by making concessions to Forstmann out of concern for their liability to the noteholders rather than maximizing the sale price of the company for the stockholders' benefit.[80] The Delaware Supreme Court affirmed these findings.[81]

2. The Delaware Supreme Court Decision

The Delaware Supreme Court approached the Revlon Board's transactions by distinguishing between measures adopted to protect the corporation as an independent entity and those measures taken once it became inevitable that the corporation was to be sold and broken up.[82] Both the Rights Plan and the stock repurchase plan were upheld under the *Unocal* test since they had been adopted in defense of the corporate entity in anticipation of Pantry Pride's hostile takeover bid.[83] However, all board action taken after the "sale" and

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mediate, while the Forstmann proposal must be discounted for the time value of money because of the delay in approving the merger and consummating the transaction." *Id.* at 178 n.6.

75. The court found that protecting Revlon noteholders was an inappropriate concern for the board of directors. *See infra* note 84.

76. The court noted that neither Forstmann's nor Pantry Pride's offers were firmly in place. *Revlon*, 506 A.2d at 179 n.7.

77. *Id.* at 178.

78. Pantry Pride raised its bid to $58 per share on October 22, 1985, conditioned upon the nullification of the rights, waiver of the notes covenants and an injunction of the Forstmann asset lock-up. *Id.* at 179.

79. On October 15, 1985, the Delaware Court of Chancery issued a ruling prohibiting the further transfer of Revlon's assets. On October 23, 1985, the chancery court preliminarily enjoined the "lock-up," "no-shop," and cancellation fee provisions of the Revlon-Forstmann agreement. MacAndrews & Forbes Holdings, Inc. v. Revlon, Inc., 501 A.2d 1239 (Del. Ch. 1985).

80. *Id.* at 1249-50.

81. *Revlon*, 506 A.2d at 184.

82. Nachbar, *supra* note 7, at 476.

83. The stock repurchase plan was upheld as "reasonable in relation to the

"break-up" of Revlon became "inevitable" could not be justified as having served the purpose of protecting the corporate entity.[84]

> [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 [B]oard's authorization permitting management to negotiate a merger or buyout with a third party was a recognition that the company was for sale. 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. This significantly altered the board's responsibilities under the *Unocal* standards. It no longer faced threats to corporate policy and effectiveness, or the stockholders' interest, from a grossly inadequate bid. The whole question of defensive measures became moot. The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company.[85]

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threat posed" by Pantry Pride's inadequate offering price. *Revlon*, 506 A.2d at 181. The court upheld the adoption of the "poison pill" Rights Plan as having protected Revlon shareholders from Pantry Pride's "junk bond" financing and the break-up of Revlon at an inadequate price. However, the "continued usefulness of the Rights Plan was rendered moot once offers for Revlon exceeded $57.25." *Id.* This was so because when the Revlon Board adopted the Rights Plan it had resolved to redeem the rights in connection with any cash offer proposal of $57.25 or more per share. *Id.*

84. The court affirmed the injunction entered by the chancery court against the "lock-up" option, cancellation fee and "no-shop" provisions under *Unocal* as breaches of the directors' fiduciary duty of loyalty. *Id.* at 184. Both provisions effectively ended the bidding contest at a time when the board's primary duty was to act as an auctioneer. *Id.* at 183. The court determined that the board's decision to enter into these agreements was primarily motivated by its concern over threats of suit by the noteholders. In supporting the noteholders at the expense of the shareholders, the Revlon Board breached its duty of loyalty. The court concluded that such concern for non-stockholder interests is inappropriate during a corporate auction, since the object of the auction is to sell the corporation to the highest bidder. *Id.* at 182.

The court emphasized that

> a [l]ock-up is not *per se* illegal under Delaware law. . . . Such options can entice other bidders to enter a contest for control of the corporation, creating an auction for the company and maximizing shareholder profit. . . . However, lock-ups . . . which end an active auction and foreclose further bidding operate to the shareholders' detriment.

Id. at 183.

85. *Revlon*, 506 A.2d at 182 (emphasis added).

The language of this often-quoted passage leaves uncertain which of the players and which of the transactions caused the Revlon Board of Directors to assume the duty to maximize current share value.[86] The first sentence of the passage implies that the *Revlon* duty arose when the premium of Pantry Pride's offering price was high enough to induce Revlon shareholders to tender and thereby sell control of Revlon to Pantry Pride. This interpretation raises the question of whether a raider can force its target to assume the *Revlon* duty simply by making an attractive offer.[87] To answer in the affirmative would mean that friendly negotiations between companies having synergistic goals[88] could be defeated simply by a third-party's higher offer.

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86. *See* R. HAMILTON, THE LAW OF CORPORATIONS 571 (1987) ("If the 'reasonable relationship' test enunciated in *Unocal* is difficult to interpret, the Delaware Supreme Court's landmark decision in *Revlon* is positively Delphic in its obscurity."); Herzel & Shepro, *supra* note 71, at 313 (characterizing the "highly ambiguous key paragraph in the *Revlon* case" as difficult to interpret); Note, *supra* note 34, at 278 ("[D]etermining when an auction phase commences is not a settled question. [T]he *Revlon* rationale fails to help future courts identify the beginning of an auction phase in ambiguous cases."); Paley, *A Look at "Revlon" Duties, What are Directors' Obligations and When Do They Apply*, N.Y.L.J., Sept. 11, 1989, at 42, col. 3 ("While the *Revlon* decision clearly articulates the duty of the directors once a company is for sale—auctioneers charged with getting the best price for the stockholders—the case left unexplored the issue of when that duty attaches.").

87. In *TW Servs.*, Chancellor Allen inquired:

> But what of a situation in which the board resists a sale? May a board find itself thrust involuntarily into a *Revlon* [context] in which it is required to take only steps designed to maximize current share value and in which it must desist from steps that would impede that goal, even if they might otherwise appear sustainable as an arguable step in promotion of "long term" corporate or share values? *Revlon* did not address that subject but implied that a board might find itself in such a position when it said that the duty it spoke of arose "when the break-up of the company is inevitable. . . . More specifically, . . . what of a situation in which the holders of some 88% of the company's stock in effect declare [by supporting the tender offer] that they do seek a current share value maximizing transaction now. Does a director's duty of loyalty to "the corporation and its shareholders" require a board, in light of that fact alone, to enter a *Revlon* mode?

Nos. 10,427 & 10,298 (consolidated), slip op. at 27-28, *reprinted in* 14 DEL. J. CORP. L. at 1186-87. *See generally* Mirvis, *Takeover Defense v. Corporate Auctions: Practice After* "MacMillan," Nat'l L.J., June 29, 1989, at 5, col. 1 (discussing the implication of the *Revlon* decision to the propriety of defensive measures).

88. *See* R. GILSON, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 387 (1986) ("[T]wo plus two equals four; synergy exists when the answer is five or more."); HAMILTON, *supra* note 2, at 789 (describing the concept of synergy). Professor Hamilton defines synergy as:

> the value of the combined enterprise is expected to be greater than the

Although the factual background in *Revlon* involved a hostile takeover attempt by Pantry Pride, the *Revlon* opinion raised doubts about the safety of consummating a friendly merger or acquisition.[89] Once the *Revlon* duty attaches, a board of directors' discretion in selecting among bidders is severely constrained.[90]

Another reason why this interpretation seems inappropriate is that it may contradict that which is permitted under the *Unocal* decision, that is, that directors may employ reasonable defensive measures to defeat takeover attempts which the board has reason to believe would threaten long-term corporate policy and effectiveness. Were the mere announcement of a tender offer to trigger the *Revlon* duty, all measures by the target board to defend against the tender offer would be prohibited.[91] This interpretation of *Revlon* contradicts the *Unocal* decision.

Courts construing this *Revlon* passage have interpreted it to mean that Revlon's Board triggered the duty to maximize current share value when it formally authorized management to negotiate a merger or buyout with interested parties.[92] This interpretation suggests that

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> sum of its separate parts as independent companies. Such "synergistic gains" may be the result of a variety of factors [such as] unique product complementarity between the two companies, specialized resources possessed by the target, economies of scale, cost reductions, lowered borrowing costs, or the capital market's response to the combined enterprise.

Id.

89. R. GILSON & R. KRAAKMAN, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS 258 (Supp. 1989) ("Outside the setting of a hostile takeover, *Revlon* raises the open-ended issue of what follows when the identical action or decision occurs in the course of a friendly deal that is not in response to a hostile bid."); Herzel & Shepro, *supra* note 71, at 313 ("Read most broadly, *Revlon* would require searching for additional bidders whenever a friendly negotiated transaction is being considered."); Note, *supra* note 34, at 278 ("In many situations, the authorization to negotiate a sale to a third party may not signify a corporate auction but rather a preliminary step toward serious negotiations.").

90. GILSON & KRAAKMAN, *supra* note 89, at 258.

91. Measures taken to encourage higher bidding are permitted when under the *Revlon* duty. *See Freedman*, No. 9212, slip op. at 16-17, *reprinted in* 13 DEL. J. CORP. L. at 661 ("[D]efensive steps . . . are valid when designed or intended to promote higher bidding and invalid if designed to . . . stop the bidding.").

92. *See, e.g.*, Black & Decker Corp. v. American Standard, Inc., 683 F. Supp. 772 (D. Del. 1988); Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53 (Del. 1989); Barkan v. Amsted Indus., Inc. 567 A.2d 1279 (Del. 1989); Bershad v. Curtiss Wright Corp., 535 A.2d 840 (Del. 1987); *In re* Holly Farms Corp. Shareholders Litig., No. 10,350 (Del. Ch. Dec. 30, 1988), *reprinted in* 14 DEL. J. CORP. L. 1062 (1989); *In re* RJR Nabisco, Inc. Shareholders Litig., No. 10,389 (Del. Ch. Jan. 31, 1989), *reprinted in* 14 DEL. J. CORP. L. 1132 (1989); *In re* J.P.

the board might have avoided the *Revlon* duty had it chosen to resist the "inevitable break-up" of the company rather than to authorize a negotiation for its sale.

Added to the uncertainty of *who* triggered the *Revlon* duty—Pantry Pride by its premium tender offer, or Revlon directors by authorizing management to negotiate a possible merger or buyout with other parties—is the ambiguity in the opinion with respect to *what* triggered the *Revlon* duty: the fact that Revlon would be sold or that a sale to either of its bidders would result in a break-up of the corporate entity?

By using the words "sale" and "break-up" interchangeably, the court blurred the distinction between a *sale* and the *destruction* of a corporate entity.[93] The court stated that "when 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."[94] It is difficult to agree with this statement. At most, Pantry Pride's offer of $53 would have induced Revlon shareholders to tender and, in so doing, sell control of Revlon to Pantry Pride. But tendering to Pantry Pride would not necessarily ensure the "break-up" of Revlon. Rather, what made the "break-up" of Revlon "inevitable" was the Revlon Board's decision to merge with an entity determined to sell significant Revlon assets.

This theory is further supported by the court's next sentence. "The Revlon [B]oard's authorization permitting management to negotiate a merger or buyout with a third party was recognition that the company was for *sale*."[95] Perhaps the court intended the words to have the same meaning. If not, it remains unclear as to whether the board's duty to maximize current share value was triggered by the actual sale of Revlon, or the fact that such sale would lead to the company's break-up.

The language which follows these two statements indicates that what triggered the *Revlon* duty was that the sale of Revlon would

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Stevens & Co. Shareholders' Litig., 542 A.2d 770 (Del. Ch. 1988); *In re* Fort Howard Corp. Shareholders Litig., No. 9991 (Del. Ch. Aug. 8, 1988), *reprinted in* 14 DEL. J. CORP. L. 699 (1989); Yanow v. Scientific Leasing, Inc., Nos. 9536 & 9561 (Del. Ch. Feb. 5, 1988) (revised Feb. 8, 1988), *reprinted in* 13 DEL. J. CORP. L. 1273 (1988); Freedman v. Restaurant Assocs. Indus., Inc., No. 9212 (Del. Ch. Oct. 16, 1987), *reprinted in* 13 DEL. J. CORP. L. 651 (1988).

93. Reder, *supra* note 21, at 281.

94. *Revlon*, 506 A.2d at 182 (emphasis added).

95. *Id.* (emphasis added).

result in the break-up of Revlon as a corporate entity. Why else would the court strip the board of their duties to defend "the corporate bastion" from "threats to corporate policy and effectiveness" and to preserve "Revlon as a corporate entity"?[96] Were an acquiror to maintain the target as an entity, rather than liquidating its assets in a bust-up takeover, such interests would indeed require protection.[97]

Read in its entirety, the *Revlon* opinion supports this interpretation. The court repeatedly emphasized that, like Pantry Pride, both Forstmann and Adler & Shaykin intended to "bust up" Revlon using "junk bond" financing.[98] The court considered it significant that Revlon's investment banker had advised the board that a break-

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96. *Id.*

97. *See* Reder, *supra* note 21, at 278, 279 ("The directors are responsible only to the shareholders when it becomes clear to the directors that the corporation as an effective business entity will not survive in recognizable form."). *But see* Sparks, Hamermesh & Stone, *Delaware Law Considerations in Undertaking Acquisitions*, *reprinted in* 2 ACQUISITIONS & MERGERS 1989, at 43-45 (Practising Law Institute 1989):

> When a corporation's board resolves to sell the company, or when due to externalities the sale of the company is inevitable, the board has a duty to maximize value for the stockholders . . . . Thus, the [*Revlon*] Court held that once the board determined to sell the company, the board's role changed . . . .

98. Reder, *supra* note 21, at 277-278. *See Revlon*, 506 A.2d at 177, 180, 182. "Junk bonds" are bonds with below investment-grade ratings. These bonds are highly speculative and risky because of their subordinate nature, but tend to outperform other bonds, such as top-rated corporate and U.S. treasury bonds, when the economy is robust. Dunnan, *Junk Bonds: A Risky Business*, A.B.A. J., Sept. 1989, at 106. Interestingly, before the junk-bond market crumbled, Professor John C. Coffee, Jr. noted the twofold significance of junk bonds in today's takeover strategy:

> [B]idders, such as [T.] Boone Pickens, Victor Posner, Saul Steinberg, or Pantry Pride (all of whom have financed tender offers through Drexel Burnham) had previously had difficulty in obtaining credit from banks, some of whom have refused to finance "raiders" as a matter of policy. Second, commercial banks have traditionally followed conservative lending policies and have seldom been willing to finance more than 50% of the acquisition cost of a target, thus compelling bidders in the past to raise the balance from retained earnings. Yet, commercial banks have no objection to bidders incurring additional debt that is subordinated to their own loans (because from the standpoint of these banks such subordinated debt is the equivalent of equity). Thus, a bidder who can issue subordinated junk bonds (at a high interest rate) after first borrowing from commercial lenders (at a lower rate) can today finance as much as 90% of the acquisition cost. Junk bond financing appears central to the newfound ability of small bidders to tender for much larger targets.

Coffee, *supra* note 20, at 4 n.5.

up of Revlon's assets could produce a return of sixty to seventy dollars per share, while the sale of the combined assets of the company would be in the mid-fifty dollar range.[99] "The original threat posed by Pantry Pride—the break-up of the company—had become a reality which even the directors embraced," noted the court.[100]

But perhaps because of the difficulty in determining when the "break-up" of a company becomes "inevitable," the language of *Revlon* has not been interpreted to apply solely to break up transactions. Instead, Delaware courts construing *Revlon* have chosen to focus their inquiry on whether or not a company is for "sale."[101]

III. THE SALE OR TRANSFER OF CORPORATE CONTROL

In response to the *Revlon* decision, corporate planners searched for a defensive measure that could defeat a raider's hostile offer without triggering the *Revlon* duty. A safe bet seemed to be the "recapitalization."[102] The theory behind a recapitalization is that

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99. *Revlon*, 506 A.2d at 177, 180.

100. *Id.* at 182. *See* Reder, *supra* note 21, at 278 ("The authorization permitting management to negotiate a merger with a third party which was itself intent on breaking up the company was a recognition that it was not just for sale but for sale to a party who would break it up . . . ."); Note, *supra* note 34, at 278 ("The court supported this finding of inevitability with evidence of the board's willingness to break up Revlon and grant lock-up options on its various divisions."). Since Revlon was not going to be sold and thus preserved as an entity but rather to be "busted-up," the board had only one role: to get the best price for the stockholders.

101. *See, e.g.*, Yanow v. Scientific Leasing, Nos. 9536 & 9561 (Del. Ch. Feb. 5, 1988) (revised Feb. 8, 1988), *reprinted in* 13 DEL. J. CORP. L. 1273 (1988) (board charged with the *Revlon* duty where no corporate break up). *See also* Black & Decker Corp. v. American Standard, Inc., 683 F. Supp. 772 (D. Del. 1988); Barkan v. Amsted Indus., Inc., 567 A.2d 1279 (Del. 1989); Bershad v. Curtiss Wright Corp., 535 A.2d 840 (Del. 1987); *In re* Holly Farms Corp. Shareholders Litig., No. 10,350 (Del. Ch. Dec. 30, 1988), *reprinted in* 14 DEL. J. CORP. L. 1062 (1989); *In re* RJR Nabisco, Inc. Shareholders Litig., No. 10,389 (Del. Ch. Jan. 31, 1989), *reprinted in* 14 DEL. J. CORP. L. 1132 (1989); *In re* J.P. Stevens & Co. Shareholders Litig., 542 A.2d 770 (Del. Ch. 1988); *In re* Fort Howard Corp. Shareholders Litig., No. 9991 (Del. Ch. Aug. 8, 1988), *reprinted in* 14 DEL. J. CORP. L. 699 (1989); Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53 (Del. 1989); Freedman v. Restaurant Assocs. Indus., Inc., No. 9212 (Del. Ch. Oct. 16, 1987), *reprinted in* 13 DEL. J. CORP. L. 651 (1988).

Contra Reder, supra note 21, at 280 ("This is not what *Revlon* says. *Revlon* is not a change-in-control case; it is a break-up case.").

102. GILSON & KRAAKMAN, *supra* note 89, at 260. The purpose of a corporate recapitalization, or restructuring, is to increase the company's short-term value to its stockholders. Typically, a company will raise money through borrowing or otherwise and pay its shareholders a large, one-time dividend of cash, bonds, and/

control of a company is transferred to management or an affiliate without requiring the public shareholders to dispose of their shares in a formal "sale," as in the Forstmann-Revlon buyout.[103] The Delaware Court of Chancery was quick to recognize that a recapitalization and a formal "sale" are practically equivalent. Judicial opinions concerning recapitalizations "suggest a general rule for invoking *Revlon*: A transaction, defensive or otherwise, triggers *Revlon* only if it would result in a 'transfer of control.'"[104]

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or preferred stock. L. SOLOMON, D. SCHWARTZ & J. BAUMAN, CORPORATIONS—LAW AND POLICY 1131 (2d ed. 1988). In 1986, Professor John C. Coffee wrote, "[O]ver the last two years [the financial restructuring] has become the principal long-term takeover defense strategy of those firms who believe themselves to be potential targets." Coffee, *supra* note 20, at 27.

103. *See* Fogg & Solovay, *Developments in Responses to Unsolicited Tender Offers*, *reprinted in* 2 ACQUISITIONS & MERGERS 1989, at 444 (Practising Law Institute 1989).

> [In a recapitalization], shareholders receive an up-front distribution of cash and retain an equity interest (the "stub stock") in the Target, which as a result of the recap becomes a highly leveraged entity. . . . The cash distributed is funded by a combination of senior bank debt and high-yield subordinated debt. These "leveraged cashouts" or "partial leveraged buyouts" provide the public shareholders with an opportunity to receive a substantial cash payment (in relation to the current trading price of the company's stock) on a current basis while also affording them an opportunity to participate in the future "upside" of the target through their continuing as equity investors in a corporation that remains an independent public entity.

104. GILSON & KRAAKMAN, *supra* note 89, at 259. *See Freedman*, No. 9212, slip op. at 16, *reprinted in* 13 DEL. J. CORP. L. at 661 ("The *Revlon* case recognizes an obligation on the part of a board of directors, once it is clear to the board that the corporation is to be subject to a *change in control*, to attempt to maximize the amount to be received by shareholders.") (emphasis added); Paley, *supra* note 86, at 42 ("These cases suggest that the *Revlon* duties are applicable whenever a board authorizes a transaction which results in a shift of *effective control* of the corporation from the existing stockholders to another party or group." (emphasis added)).

In Black & Decker Corp. v. American Standard Inc., 682 F. Supp. 772 (D. Del. 1988), American Standard's Board of Directors adopted a recapitalization plan in response to a tender offer for all of its outstanding stock at $68 per share. The plan would give shareholders $59 in cash and $10.80 in face value ($5 market value) junior subordinated discount debentures and a "stub equity" of about $7. *Id.* at 782. Black & Decker's final bid stood at $73 when it moved for injunctive relief for other reasons. *Id.* at 784. The court held that a transaction that results in a change in control of a company constitutes a "sale" and triggers the *Revlon* duty. American Standard's recapitalization plan would have effected a change in control. The recapitalization plan called for the creation of a company ESOP that would purchase $80 million worth of "stub equity" owned by shareholders. *Id.* at 778. Each share of stock owned by management had the right to be exchanged for 11.7 shares of the stub equity. *Id.* at 783. Were the recapitalization to take effect management could own 23.9% of the outstanding stock, the ESOP and savings

A. Ivanhoe Partners, Inc. v. Newmont Mining Corp.

The first Delaware Supreme Court case to interpret the *Revlon* decision was *Ivanhoe Partners, Inc. v. Newmont Mining Corp.*[105] The court in *Ivanhoe* narrowly construed *Revlon*, concluding that the *Revlon* duty was not implicated by a corporate sale of less than an absolute majority control block of Newmont stock.[106]

1. Facts and Holding

When Ivanhoe Partners, Inc. (Ivanhoe)[107] obtained 9.95% of Newmont Mining Corporation's (Newmont) stock,[108] a previously negotiated standstill agreement[109] between Newmont and its largest shareholder, Consolidated Gold Fields PLC (Gold Fields), became void, thereby enabling Gold Fields to purchase Newmont stock without limit.[110] In order to prevent its shareholders from tendering into

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plan could own 30.6%, and the public would own only 45.5%. *Id.* at 782. The court found that because the public shareholder ownership could be reduced to 45.5%, the recap permitted a change of control to management. The board's approval of the recapitalization plan was recognition that the company was for sale. *Id.* at 784.

In City Capital Assocs. Ltd. Partnership v. Interco Inc., 551 A.2d 787 (Del. Ch. 1988), Interco management proposed a substantial corporate restructuring in response to the hostile bid of City Capital Associates. The restructuring involved large distributions of cash and securities to the stockholders of Interco. To pay for the distributions, Interco contemplated selling a significant portion of its assets. Importantly, unlike the restructurings in American Standard and MacMillan (see *infra* text and accompanying notes 129-73), the Interco restructuring did not treat public shareholders differently from management and would not result in management controlling a substantial percentage of Interco's stock. The chancery court held that the board of Interco had no duty to conduct an auction of the company. *Black & Decker*, 682 F. Supp. at 803.

105. 535 A.2d 1334 (Del. 1987).

106. *Id.* at 1345.

107. The nominal plaintiff, Ivanhoe Partners, Inc. is an investment partnership organized and controlled by T. Boone Pickens, Jr. *Id.* at 1337 n.1.

108. *Id.* at 1338. Newmont Mining Corporation is one of the largest gold producers in North America. *Id.* at 1336.

109. *Id.* at 1338. Standstill agreements are "provisions precluding the recipient from buying Target shares or making an acquisition proposal to [the] Target without the prior consent of the Target Board." Fogg & Solovay, *supra* note 103, at 460.

110. *Ivanhoe*, 535 A.2d at 1338. At the time the standstill agreement was negotiated, Gold Fields held 26% of Newmont's stock. *Id.* By the terms of the agreement, Gold Fields agreed to limit its ownership interest in Newmont to 1/3 of Newmont's stock and to limit its representation on Newmont's board to 1/3 of the total number of directors. The standstill agreement was for a term of 10 years, but provided that Gold Fields could terminate the agreement if a third party acquired

a two-tiered, partial tender offer[111] by Ivanhoe,[112] the Newmont Board negotiated a new standstill agreement with Gold Fields whereby Gold Fields could acquire a maximum of 49.9% of Newmont stock but elect only 40% of Newmont's Board of Directors.[113] The new agreement also required Gold Fields to support management's nominees for the remaining board positions,[114] and prohibited Gold Fields from transferring its stock to a third party who refused to be bound by the agreement.[115]

To facilitate Gold Field's purchase of Newmont stock from the open market, the Newmont Board declared a large dividend to its shareholders.[116] Using the proceeds from this dividend, Gold Fields conducted a "street sweep"[117] of Newmont's stock and thereby obtained a total of 49.7% of the company's equity.[118]

Ivanhoe sued for a preliminary injunction to rescind the standstill agreement, the dividend, and the street sweep as entrenchment devices in violation of the board's fiduciary duties owed to Newmont

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9.9% or more of Newmont's outstanding shares. Paley, *supra* note 86, at 42, col. 1. Paley adds that Ivanhoe Partners "deliberately" purchased enough shares to trigger Gold Fields' right to terminate the standstill agreement so that Newmont would have to "contend with the threat from Ivanhoe as well as a possible threat from Gold Fields." *Id.*

111. A two-tiered, partial tender offer refers to a

> two step acquisition in which the first step (front end) is a cash tender offer for 51% of the corporation's outstanding stock and the second step (back end) is a merger in which the remaining shareholders of the target company typically receive securities of the bidder valued below the cash consideration offered in the first step tender offer.

Coffee, *Regulating the Market for Corporate Control, A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145, 1162-73 (1984).

112. Ivanhoe commenced a hostile tender offer for 42% of Newmont's stock at $95 per share and hoped to acquire all remaining shares in a second-stop transaction at the same cash price. Newmont directors rejected this offer, as well as a subsequent bid for $105 per share, as inadequate. *Ivanhoe*, 535 A.2d at 1339.

113. *Id.* at 1340.

114. *Id.* "Newmont's Board consisted of nine members: three management directors; two outside directors affiliated with Gold Fields; and four independent directors." *Id.* at 1339 n.10.

115. *Id.* at 1340.

116. The $33 in cash per share dividend was financed by the sale of Newmont's non-gold assets. *Id.* at 1340 n.14.

117. "A 'street sweep' refers to the rapid acquisition of securities on the open market during and shortly after the pendency of a tender offer for the same class of securities. The shares are ordinarily purchased at a premium from arbitragers." *Id.* at 1337 n.3.

118. Gold Fields purchased 15.8 million shares of Newmont at an average price of $96 per share. Paley, *supra* note 86, at 42.

shareholders. Ivanhoe argued that Newmont directors violated *Revlon* by refusing to consider Ivanhoe's bid. The Delaware Court of Chancery ultimately refused to rescind these transactions,[119] and the Delaware Supreme Court affirmed this decision.[120]

2. The Delaware Supreme Court Decision

On appeal to the Delaware Supreme Court, Ivanhoe argued that Newmont directors had breached their *Revlon* duty by refusing to entertain Ivanhoe's bid.[121] The court held that *Revlon* did not apply and instead evaluated and upheld the standstill agreement, the dividend and the street sweep under the *Unocal* test.[122]

> For *Revlon* to apply in this situation, it must be apparent that the sale of Newmont was "inevitable." The record, however, does not support such a finding for two reasons. First, 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. Ultimately, this goal was achieved by the standstill agreement and related defensive measures. Second, there was neither a bidding contest, nor a sale. The only bidder for Newmont was Ivanhoe. Gold Fields was not a bidder but wished to protect its already substantial interest in the company. It did so through the street sweep. Thus, the Newmont Board did not "sell" the company to Gold Fields. The latter's purchases were from private sellers. . . . Even though Newmont's declaration of the dividend facilitated the street sweep,

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119. Ivanhoe Partners, Inc. v. Newmont Mining Corp., 533 A.2d 585, 609 (Del. Ch. 1987).

120. *Ivanhoe Partners, Inc.*, 535 A.2d at 1346.

121. *Id.* at 1337.

122. *Id.* at 1345. The court upheld Newmont's transactions under the *Unocal* analysis, concluding that:

> Newmont's directors had both the duty and responsibility to oppose the threats presented by Ivanhoe and Gold Fields. Further, the actions taken were reasonable in relation to the threats posed. The comprehensive defensive scheme consisting of the dividend, standstill agreement, and street sweep accomplished the two essential objectives of thwarting the inadequate coercive Ivanhoe offer, and of insuring the continued interest of the public shareholders in the independent control and prosperity of Newmont. Under the circumstances, the board's actions taken by a majority of independent directors, are entitled to the protection of the business judgment rule.

Id. (citations omitted).

it did not constitute a "sale" of the company by Newmont.[123]

Crucial to the court's determination that the *Revlon* duty did not apply was that the majority of Newmont's stock remained publicly held and that public shareholders controlled 40% of Newmont's Board of Directors.[124] Thus, the court reasoned that control of the Newmont company remained "independent."

It is arguable, however, that the Newmont company was independent only in the sense that voting control was not transferred from the public shareholders to a third party.[125] While Newmont management did not directly attempt to increase its equity stake, the standstill agreement with Gold Fields guaranteed that management would have control over Newmont.[126] The agreement assured the defeat of not only Ivanhoe's tender offer but any other raider that might make an offer while the standstill agreement was in effect. This was so because Gold Fields had agreed not to tender its shares to any third party hostile towards management. By the same measure Gold Fields was prohibited from initiating a proxy contest of its own. Viewed from this perspective, Newmont's defensive measures were as successful as a management buyout or recapitalization in transferring *effective* control to management.[127]

The *Ivanhoe* Court stated that the *Revlon* duty applies "only if it was apparent that the *sale* of Newmont was 'inevitable.'"[128] But this *sale of control* test does not provide a sound basis for the court's finding that *Revlon* did not apply, for control was taken from the public and given to management. A more reasoned rationale for the court's holding might have been that the policy expressed in *Revlon* was one against corporate sales that *break up* or dissolve corporations. Even though the transactions of Newmont shifted *effective* control to management, such transactions did not result in a break-up of the company. In *Revlon*, it was the inevitable *break-up* of the company

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123. *Id.*

124. *Id.* at 1343.

125. GILSON & KRAAKMAN, *supra* note 89, at 263. "While the court's conclusion is clear, its reasoning is not. [A] shift in control did take place: control was effectively transferred to management. . . . [T]he chief distinction between the Newmont device and Revlon's 'sale' was that Newmont shifted control to management without allowing its public shareholders to receive a premium." *Id.*

126. *Id.* at 262.

127. *Id.*

128. *Ivanhoe*, 535 A.2d at 1335 (emphasis added).

that led to the board's duty to maximize Revlon's current share value, not the fact that either Pantry Pride or Forstmann would purchase Revlon.

B. Mills Acquisition Co. v. MacMillan, Inc.

The next Delaware Supreme Court case that contributed to an understanding of when the *Revlon* duty is triggered was *Mills Acquisition Co. v. MacMillan, Inc.*[129] The *MacMillan* decision consolidated two chancery court cases involving a control contest for MacMillan, Inc.[130] In *Robert M. Bass Group, Inc. v. Evans* (*MacMillan I*),[131] the chancery court expanded the *Ivanhoe* decision, indicating that the transfer of *effective* control may trigger *Revlon*.[132]

1. *MacMillan I*

In May 1987, MacMillan, a diversified publishing and information services company, began exploring defensive measures to an anticipated hostile takeover attempt.[133] In June 1987, the MacMillan Board authorized a corporate recapitalization which contemplated absolute majority control of the restructured company in management.[134] Under the plan, the company would grant several thousand restricted company shares and options to management (the stock option plan).[135] Management would exchange the stock and options for shares of the recapitalized company.[136] MacMillan's Employee Stock Ownership Plan (ESOP)[137] would purchase a large block of

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129. 559 A.2d 1261 (Del. 1989).

130. *MacMillan I*, 552 A.2d 1227 (Del. Ch. 1988); Mills Acquisition Co. v. MacMillan, Inc., No. 10,168 (Del. Ch. Oct. 17, 1988) (*MacMillan II*), *reprinted in* 14 DEL. J. CORP. L. 772 (1989).

131. 552 A.2d 1227 (Del. Ch. 1988).

132. *Id.* at 1243.

133. *Id.* at 1229. In May 1987, Robert Maxwell announced a takeover bid for Harcourt Brace Jovanovich, Inc. (HBJ), another prominent publishing firm. Maxwell's bid was frustrated by a recapitalization implemented by HBJ. MacMillan management feared that Maxwell would make a tender offer to MacMillan shareholders and began considering a similar recapitalization plan. *Id.*

134. *Id.* at 1230.

135. *Id.* at 1229.

136. *Id.* at 1230.

137. An ESOP is completely funded by the employer with its securities. This qualified plan is "designed to provide a retirement benefit and a stake in the corporation for the employee." An ESOP is an effective defensive tactic because it pools a block of the company's stock with the company's employees. Generally, employees will refrain from tendering their shares to a hostile acquiror out of loyalty

MacMillan stock.[138] The independent ESOP trustee would be replaced by members of management, thus conferring upon management voting control over all ESOP shares.[139]

MacMillan's recapitalization originally contemplated a "one company" surviving entity. This plan was changed, however, to provide for a split of MacMillan into two separately traded companies, the "information" business and the "publishing" business.[140] The plan contemplated that management would own roughly 55% of the information business and *effective* control of 20% of the publishing business.[141]

This plan was formally approved by MacMillan's Board of Directors on September 22, 1987.[142] However, on the advice of its investment banker, the board agreed to reduce prospective management-ownership in the information business from 55% to 39%, so as to prevent the restructuring from being "regarded as a transfer of corporate control from the public shareholders to management."[143]

On May 17, 1988, Robert M. Bass Group (Bass Group) made an offer to the MacMillan Board to consensually purchase any and all of MacMillan's outstanding common stock at $64 per share.[144] Before disclosing the Bass Group's offer to MacMillan shareholders, on May 18, 1988, MacMillan directors recommended and the shareholders approved management's stock option plan.[145] On May 30, 1988, the MacMillan Board gave final approval to management's recapitalization plan, and rejected the Bass Group's offer.[146]

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to management or fear of losing their jobs. R. HAMILTON, THE LAW OF CORPORATIONS 674 (3d ed. 1983).

138. *MacMillan I*, 552 A.2d at 1230.

139. *Id.*

140. *Id.* at 1231.

141. *Id.* In the original plan, the information business (Information) would have two classes of common stock:

> Class A, entitled to ten votes per share, and constituting voting control of the company; Class B, having one vote per share. All of the Class A shares would be owned by the management group. . . . MacMillan would issue to Information, a "blocking" preferred stock of Publishing . . . . Thus, Information (which would be controlled by management) would own 20% of Mac[M]illan publishing voting power.

Id.

142. *Id.* at 1231-32.

143. *Id.* at 1235.

144. *Id.* at 1234.

145. *Id.*

146. *Id.* at 1236.

Under the recapitalization plan, MacMillan shareholders would exchange their shares of stock[147] for a cash dividend of $52.35, a debenture valued at $4.50, and "stub shares"[148] in both the information business and the publishing business, for a total value ascribed at $64.15 per share.[149] MacMillan management and the company ESOP would exchange their restricted stock and options for restricted shares of the information business. Through this, management would obtain 39.2% of the information business and 3.2% of the publishing business. The ESOP would hold 26% of the publishing business and 4% of the information business.[150]

On June 4, 1988, the Bass Group increased its cash offer for any and all MacMillan shares to $73 per share, and proposed in the alternative a restructuring plan which differed from MacMillan's only by offering a higher price to shareholders ($58 per share) and treating MacMillan management the same as the shareholders.[151] MacMillan directors rejected the Bass Group's offer and restructuring.[152] Bass moved to preliminarily enjoin the MacMillan restructuring, and on July 14, 1988, the Delaware Court of Chancery granted its motion.[153]

2. The Delaware Court of Chancery Decision

The Bass Group argued that the MacMillan recapitalization implicated and violated the *Revlon* duty since control of the company would be transferred to management without having obtained the highest available value for MacMillan shareholders.[154] The chancery court did not rule on this claim, concluding instead that the MacMillan Board had violated its fiduciary duties under the *Unocal* standard.[155]

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147. Delaware law permits a board of directors to deal in the company's stock. *See supra* note 52.

148. *See supra* note 103 (discussing restructurings and stub shares).

149. Shareholders would receive a one-half stub share of the information business, valued at $2.20, and a stub share in the publishing business, valued at $5.10. *MacMillan I*, 552 A.2d at 1236.

150. *Id.* at 1236 n.26.

151. *Id.* at 1237. MacMillan management would not receive information business stock but instead would receive the restructuring dividend, as would all MacMillan shareholders. *Id.*

152. *Id.* at 1238.

153. *Id.* at 1247.

154. *Id.* at 1238.

155. *Id.* at 1238-39. Vice-Chancellor Jacobs found that the restructuring constituted an "unreasonable and disproportionate antitakeover response to the Bass

However, in examining the propriety of the MacMillan restructuring plan under *Unocal*, the chancery court rejected the MacMillan Board's contention that the Bass Group's restructuring plan would amount to a "sale" of MacMillan while the Macmillan restructuring plan would not. The court stated that the original MacMillan restructuring proposal, which contemplated 50% ownership by management, would amount to a "sale" and would "likely trigger the *Revlon* duty," had the court reached that question.[156] Even more enlightening, the vice-chancellor stated that, by reducing management ownership from 50% to 39% of the information business, "the objective of giving management *effective* control would still be accomplished. The change, then, was one of form, not substance, a conclusion supported by charts prepared for the Board . . . which stated that management would obtain 'voting control' over Information even with a block of less than fifty percent."[157]

This language is significant in light of the *Ivanhoe* opinion, wherein the court was not impressed with *effective* control having been transferred from the public shareholders to Newmont management, but rather stressed the importance of a 50% voting block in triggering the *Revlon* duty. The vice-chancellor's opinion suggests that the appropriate *Revlon* inquiry regarding a transfer of less than a majority voting block is whether the transfer will result in a "transfer of *effective* control.[158]

3. *MacMillan II*

On the same day the chancery court preliminarily enjoined MacMillan's restructuring, MacMillan management authorized its investment advisors to explore a possible sale of the company.[159] This effort revealed six potential bidders.[160]

Group proposals," and thus violated the board's fiduciary duties of care and loyalty. *Id.* at 1238. The vice-chancellor further determined that the Bass Group's revised offer of $73 per share cash and alternative restructuring plan were both superior to the MacMillan restructuring and that the only threat posed by the Bass offers was "to the incumbency of the Board or to the management group's expectation of garnering a 39% ownership interest in Information on extremely favorable terms." *Id.* at 1241 n.34. "All Bass Group offers proposed the same price to all stockholders, were not 'frontend-loaded,' and their financing did not depend upon a 'break-up' of the Company." *Id.* at 1240.

156. *Id.* at 1243.

157. *Id.* at 1243 (emphasis added). *See also Freedman*, No. 9212, slip op. at 3, 4, *reprinted in* 13 DEL. J. CORP. L. at 651 (37% of the voting stock found by court to represent *effective* voting control).

158. GILSON & KRAAKMAN, *supra* note 89, at 265-66.

159. *Mills Acquisition Co.*, 559 A.2d at 1272.

160. *Id.* Potential bidders included the Bass Group, Gulf & Western, Kohlberg

On July 20, 1988, Maxwell Communications Corporation (Maxwell)[161] proposed a consensual all cash merger with MacMillan.[162] A bidding contest ensued between Maxwell and MacMillan's "white knight" Kohlberg Kravis Roberts & Company (KKR), a leveraged buyout specialist firm. Maxwell's overtures to acquire the "whole company" and operate the company as a going concern were rejected by MacMillan management, which would consider only a break-up sale of MacMillan's assets.[163] On September 11, 1988, MacMillan directors abandoned their recapitalization plan and instead recommended to MacMillan shareholders a buyout by KKR.[164]

On September 27, 1988, MacMillan directors approved a two-tiered leveraged buyout of the MacMillan company by KKR.[165] The board agreed to grant KKR a lock-up option to purchase seven of MacMillan's divisions, several of which were considered "crown jewels."[166] This sale would enable KKR to finance the back-end of its two-tiered tender offer.[167] Maxwell moved to enjoin the MacMillan-KKR asset lock-up agreement. The Delaware Court of Chancery denied this request.[168] The Delaware Supreme Court reversed.[169]

4. The Delaware Supreme Court Decision

While the *MacMillan* opinion is often quoted for its insight into how the *Revlon* duty must be carried out,[170] the opinion also shed

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Kravis Roberts & Co., Maxwell Communications, McGraw Hill, and News America Corporation. *Id.* at 1272 n.17.

161. Maxwell Communications Corporation is substantially controlled by Robert Maxwell. *Id.* at 1264.

162. *Id.* at 1272.

163. *Id.* at 1273.

164. *Id.* at 1274.

165. *Id.* at 1277-78.

166. *Id.* at 1286. A "crown jewel" has been described as

> the most prized asset of a corporation, i.e.[,] that which makes it an attractive takeover target. A defensive tactic against a hostile tender offer may be to sell this asset to another party, thereby removing the asset that the unfriendly bidder was hoping to acquire and encouraging it to cease its offer without purchasing any shares of the subject company.

HAMILTON, *supra* note 2, at 816.

167. *Mills Acquisition*, 559 A.2d at 1286.

168. Mills Acquisition Co. v. MacMillan, Inc., No. 10,168 (Del. Ch. Oct. 17, 1988), *reprinted in* 14 DEL. J. CORP. L. 772 (1989).

169. Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261 (Del. 1989).

170. The court listed various factors a board of directors in a *Revlon* context may consider when examining alternative offers in a bidding contest:

substantial light on the circumstances that will trigger the *Revlon* duty, despite the court's proclamation that:

> [t]his case does not require a judicial determination of when MacMillan was "for sale." By any standards this company was for sale in both *MacMillan I and II*. In any event, the board of directors formally concluded on September 11 that it would be in the best interests of the stockholders to sell the company.[171]

Although the *MacMillan* Court thought it unnecessary to discuss the particular circumstances that triggered the *Revlon* duty, the court indicated that it was less inclined to place decisive weight on the form of a corporate transaction when determining whether such a transaction gives rise to the *Revlon* duty. The *Revlon* duty applies "whether the 'sale' takes the form of an active auction, a management buyout, or a 'restructuring' such as that which the Court of Chancery enjoined in *MacMillan I*."[172] Implicit in this statement is the court's accordance with the vice-chancellor's perception in *Ivanhoe* that a restructuring, which transfers *effective* control to management, will trigger the *Revlon* duty. In so stating, the court indicates that transactions of a board of directors may cause the board to involuntarily assume the *Revlon* duty where the board has not formally resolved to sell the company. However, the court recognized the limits to this involuntary application of the *Revlon* duty:

> Clearly not every offer or transaction affecting the corporate structure invokes the *Revlon* duties. A refusal to entertain offers may comport with a valid exercise of business judgment. Circumstances may dictate that an offer be rebuffed, given the nature and timing of the offer; its legality, feas-

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> In assessing the bid and the bidder's responsibility, a board may consider, among various proper factors, the adequacy and terms of the offer; its fairness and feasibility; the proposed or actual financing for the offer, and the consequences of that financing; questions of illegality; the impact of both the bid and the potential acquisition on other constituencies, provided that it bears some reasonable relationship to general shareholder interests; the risk of nonconsummation; the basic stockholder interests at stake; 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.

Id. at 1282 n.29 (citations omitted).

171. *Id.* at 1285.

172. *Id.*

> ibility and effect on the corporation and the stockholders; the alternatives available and their effect on the various constituencies, particularly the stockholders; the company's long term strategic plans; and any special factors bearing on stockholder and public interests.[173]

This passage reaffirms the principle that corporate governance is the domain of the board of directors. Such a reaffirmation further depreciates *Revlon*'s suggestion that a raider can force its target into assuming the *Revlon* duty. The court indicated that, aside from a transaction that transfers control or breaks up a company, a board's defensive measures will be reviewed under the *Unocal* standard. The importance of this language was not revealed, however, until the Delaware Supreme Court's most recent discussion of *Revlon* in *Paramount Communications, Inc. v. Time Inc.*[174]

IIV. MEASURES EFFECTING A CORPORATE BREAK-UP

A. Paramount Communications, Inc. v. Time Inc.

The facts that led to the *Paramount* decision presented an ideal context for the Delaware Supreme Court to address the issue, raised by *Revlon* and touched upon in *MacMillan*, of whether a company that did not wish to sell itself could involuntarily "find itself" under the *Revlon* duty. In particular, the Paramount company asserted that a merger agreement negotiated between Time and Warner triggered the *Revlon* duty. The court disagreed.[175]

1. Facts and Holding

In 1983, the publishing company, Time Inc., began exploring the possibility of expanding into the entertainment industry on a global basis.[176] By 1989, Time had developed the goal of creating and owning its own video programming so that it could gain greater control over the quality and price of its film products.[177] Time management was interested in pursuing a joint venture with an

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173. *Id.* at 1285 n.35.
174. Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990).
175. *Id.* at 1142.
176. *Id.* at 1143.
177. *Id.*

entertainment company that would help Time achieve these goals.[178] After extensive research Time concluded that Warner Communications (Warner) would best "fit" in a consolidation with Time because of Warner's successful movie studio, its presence in the music business, and its international distribution of assets and capabilities.[179]

Negotiations between the two companies focused principally upon issues of corporate governance.[180] Time's primary concern was to prevent a joint venture from threatening the editorial integrity and journalistic focus of the company, referred to as the "Time Culture."[181]

In March 1989, Time and Warner agreed to a stock exchange merger.[182] Time would be the acquiring company and would change its name to Time-Warner, Inc.[183] The corporate board of the surviving company would equally represent both Time and Warner,[184] and the editorial committee would consist of a majority of Time representatives.[185] In exchange for dictating the corporate governance arrangement in the new company, and because of concern that negotiations with Warner would give the appearance of Time having put itself "in play,"[186] Time and Warner agreed to a "no-shop" clause, prohibiting Time from considering consolidation proposals from others, and an automatic exchange of each company's stock following certain triggering events.[187]

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178. *Id.* at 1144.

179. *Id.* at 1144-45.

180. *Id.* at 1145.

181. *Id.*

182. *Id.* at 1146. A stock for stock merger occurs when the acquiring corporation exchanges its stock for stock in the target corporation at a fixed ratio. Note, *State Takeover Statutes and a Proposal to Amend the Williams Act*, 49 OHIO ST. L.J. 1129, 1130 n.8 (1986).

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

Warner would merge with a Time subsidiary, TW Sub, Inc. Each share of Warner would be converted into 0.465 shares of Time. After the merger, the former stockholders of Time would own about 38% of the combined Time-Warner and the former stockholders of Warner would hold 62% of the combined company.

184. The Time-Warner Board would consist of 24 members: 12 Time members and 12 Warner members. *Id.*

185. *Id.*

186. To be "in play" means to be perceived as a target company:

> This may happen either when a takeover bid is publicly announced, or when a person who has been a hostile bidder in the past files a Schedule 13D showing he has acquired 5% or more of the company. When a company is "in play[,]" the [arbitragers] assume that it will be acquired by someone, and the only question is by whom.

SOLOMON, SCHWARTZ, & BAUMAN, *supra* note 102, at 1100.

187. *Paramount*, 571 A.2d at 1146-47. The share exchange agreement gave each

Shortly before Warner shareholders were to vote on the merger,[188] Paramount made a surprise all-cash, all-shares offer for Time at

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company the option to trigger an exchange of their respective shares. If triggered, Warner would acquire approximately 11.1% of Time, and Time would acquire approximately 9.45% of Warner. Time directors described the nature of the Share Exchange Agreement as "part of a continuing aspiration on both companies' part to make an investment in each other and recognize the values that are inherent in each company, and is an important symbol of the regard that each company has for the other." Time Defendants' Brief in Opposition to Plaintiffs' Motion for a Preliminary Injunction, at 48, Paramount Communications Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990).

Time was willing to pay a premium because "we were talking about . . . an acquisition, where our culture would prevail, where the name of the company would be Time-Warner and not Warner-Time." Time Defendants' Brief in Opposition to Plaintiffs' Motion for a Preliminary Injunction, at 43, Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990).

188. Because of the structure of the agreement, Delaware law would require Warner stockholders to approve the merger agreement by a majority vote. Section 251(c) of the Delaware General Corporation Law provides in relevant part:

> (c) The agreement required by subsection (b) of this section [regarding a merger agreement] shall be submitted to the stockholders of each constituent corporation at an annual or special meeting for the purpose of acting on the agreement. . . . At the meeting, the agreement shall be considered and a vote taken for its adoption or rejection if a majority of the outstanding stock of the corporation entitled to vote thereon shall be voted for the adoption of the agreement . . . it shall become effective . . . .

DEL. CODE ANN. tit. 8, § 251(c) (Michie Supp. 1988).

Delaware law did not require Time stockholder approval. Section 251(f) provides, in relevant part:

> Notwithstanding the requirements of subsection (c), unless required by its certificate of incorporation, no vote of the stockholders of a constituent corporation surviving a merger shall be necessary to authorize a merger if (1) the agreement of merger does not amend in any respect the certificate of incorporation of such constituent corporation, (2) each share of stock of such constituent corporation outstanding immediately prior to the effective date of the merger is to be an identical outstanding or treasury share of the surviving corporation after the effective date of the merger, and (3) either no shares of common stock of the surviving corporation and no shares, securities or obligations convertible into such stock are to be issued or delivered under the plan of merger, or the authorized unissued shares or the treasury shares of common stock of the surviving corporation to be issued or delivered under the plan of merger plus those initially issuable upon conversion of any other shares, securities or obligations to be issued or delivered under such plan do not exceed 20 percent of the shares of common stock of such constituent corporation outstanding immediately prior to the effective date of the merger.

DEL. CODE ANN. tit. 8, § 251(f) (Michie 1974).

However, because of the amount of stock that would be issued by Time, New York Stock Exchange Rules required Time stockholders to approve the merger. *Paramount*, 571 A.2d at 1146.

$175 per share, conditioned upon termination of the Time-Warner merger agreement and the share exchange agreement.[189] Following the announcement of Paramount's offer, the price of Time stock rose from $126 to $170 per share.[190]

Time perceived the Paramount offer as inadequate in price and contrary to Time's long-term goals.[191] Fearing that Time stockholders would not comprehend the long-term benefits of the Warner merger and would tender to Paramount's cash premium, Time and Warner revised their merger agreement to eliminate the need for Time shareholders' approval. Instead, Time would acquire Warner by making an all-cash tender offer for 51% of Warner's outstanding stock.[192] In so doing, Time would increase the premium it would pay for Warner shares, and would assume additional debt to facilitate the purchase.[193] This premium cash bid would be followed by a merger in which the remaining Warner shares would be exchanged for Time securities.[194]

Paramount raised its offer to $200 per share.[195] Time rejected this offer as inadequate when compared with the long-term value Time anticipated in the Time-Warner consolidation.[196]

Following rejection by the Time Board, Paramount moved to

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189. *Paramount*, 571 A.2d at 1147. The offer was extended on June 7, 1989, two weeks before the scheduled stockholder meetings. Paramount was willing to negotiate on all aspects of the offer, including price. Paley, *supra* note 86, at 42.

190. *Paramount*, 571 A.2d at 1147. Time stock "hit a high of $182-3/4 . . . ." *Id.*

191. *Id.*

192. *Id.* at 1148. Time commenced a tender offer for 100 million Warner shares at $70 cash per share. The remaining Warner shares would be acquired in a merger for $70 cash per share or securities having a value of $70 per share. Paley, *supra* note 86, at 42.

193. *Paramount*, 571 A.2d at 1148. Time would pay a 56% premium for Warner shares, 44% higher than the first proposal. *Id.*

194. Herzel & Shepro, *Time Beats Paramount in the Delaware Courts*, Financial Times, Aug. 3, 1989, at 33. The authors say that,

> Time and Warner were exploiting a discrepancy in US [sic] corporate law and stock exchange rules. By becoming the bidder Time no longer had to obtain shareholder approval. However, Time's bid drastically changed the economic bargain between Time and Warner shareholders. It also entailed a large amount of new debt for the surviving entity and lost the benefits of pooling of interests accounting, [which] combines the financial statements of both companies and avoids the creation of goodwill on the books of the acquirer—the difference between purchase price and book value.

Id.

195. *Paramount*, 571 A.2d at 1149.

196. *Id.* The Paramount $200 per share offer was greater in immediate value than the Time-Warner agreement. *Id.*

enjoin the Time-Warner consolidation.[197] On July 14, 1989, the Delaware Court of Chancery denied the injunction.[198] The Delaware Supreme Court affirmed.[199] A difference in reasoning warrants a discussion of both opinions.

2. The Delaware Court of Chancery Decision

In addressing the *Revlon* question Chancellor Allen inquired: who, as between the board of directors or the shareholders, should be the agency to choose whether a company will be managed for current value maximization or long-term value creation?[200] After deliberating, the chancellor concluded:

> [U]nder Delaware law, directors are under no obligation to act so as to maximize the immediate value of the corporation or its shares, except in the special case in which the corporation is in a "*Revlon* mode." Thus Delaware law does recognize that directors, when acting deliberately, in an informed way, and in the good faith pursuit of corporate interests, may follow a course designed to achieve long-term value even at the cost of immediate value maximization.[201]

Chancellor Allen then framed the legal issue raised by the case as, "[W]hen must a board shift from its ordinary long-term profit

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197. As in most similar suits, Time shareholders wishing to tender to Paramount's offer also sought injunctive relief in this action.

According to Herzel & Shepro,

> Paramount needed the co-operation of Time's board to surmount the many legal difficulties in its way. . . . Paramount's biggest strategic weakness was that it needed the approval of the FCC and cable television regulators across the country to acquire Time's many broadcasting and cable television interests. Time was doing everything in its power to make this impossible and Paramount desperately needed to make peace with Time's [B]oard. . . . Since the Time [B]oard had no interest in any combination with Paramount, the only practical way Paramount could achieve this was through litigation in the Delaware courts.

Herzel & Shepro, *supra* note 194, at 33.

198. *Paramount*, Nos. 10,866, 10,670 (consolidated) & 10,935, slip op. at 76-78, *reprinted in* 15 DEL. J. CORP. L. at 748-50.

199. Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990).

200. *Paramount*, Nos. 10,866, 10,670 (consolidated) & 10,935, slip op. at 2, *reprinted in* 15 DEL. J. CORP. L. at 707.

201. *Id.*, slip op. at 50-51, *reprinted in* 15 DEL. J. CORP. L. at 734.

maximizing mode to the radically altered state recognized by the *Revlon* case in which its duty . . . is to exercise its power in the . . . pursuit of immediate maximization of share value?"[202]

The plaintiffs contended that the original stock exchange merger agreement triggered the *Revlon* duty because it was intended to transfer control of Time to Warner shareholders. The defendants countered that the purpose of the merger was not to sell Time but rather to "improve the company's long-term performance."[203] Though the court agreed that the Time Board lacked the subjective intent to sell the company, the chancellor cited *MacMillan* and proclaimed that "it now appears resolved that a subjective disinclination to sell the company will not prevent the [*Revlon*] duty from arising where an extraordinary transaction including, at a minimum, a change of corporate control is involved."[204]

The plaintiffs claimed that the original stock exchange merger agreement would have resulted in a shift in control of Time to Warner shareholders.[205] Time shareholders would have owned only 38% of the combined company. This would constitute a "sale," argued the plaintiffs. Thus, according to the court's ruling in *MacMillan*, Time directors had breached their *Revlon* duty by failing to consider Paramount's bid in pursuit of their duty to maximize current shareholder value.[206] Time directors countered, claiming no sale of corporate control would have occurred because the original merger would have resulted in shared control in the combined company.

The chancellor determined that even though 62% of the Time-Warner stock would have been held by former Warner shareholders, equity ownership in the combined company would remain in the open market, the holders of which are far too incohesive to effect a control block in the company. "[N]either corporation could be said

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202. *Id.*, slip op. at 51, *reprinted in* 15 DEL. J. CORP. L. at 735.

203. *Id.*, slip op. at 54-56, *reprinted in* 15 DEL. J. CORP. L. at 736-38.

204. *Id.*

205. *Id.*, slip op. at 54, *reprinted in* 15 DEL. J. CORP. L. at 736. *See* Franklin, *Defining "For Sale,"* NAT'L. L.J., June 29, 1989, at 5, col. 3:

> Whether or not Time was for sale boils down to whether there would be a change in control at Time after the merger, said experts, who added they were not aware of any cases where a merger had been found to be a sale and predicted such a finding would dampen any future interest in stock mergers.

206. *Paramount*, Nos. 10,866, 10,670 (consolidated) & 10,935, slip op. at 54, *reprinted in* 15 DEL. J. CORP. L. at 736.

to be acquiring the other. Control remained in a large, fluid, changeable and changing market. . . . [N]o control passed to anyone in the transaction contemplated."[207] However, a stock exchange agreement could give rise to the *Revlon* duty, noted Chancellor Allen, if the exchange were to a private company.[208] Chancellor Allen concluded that the original Time-Warner stock exchange agreement did not involve a change in control, and as such, the transaction did not impose the *Revlon* duty upon Time directors.[209]

The chancellor next addressed plaintiffs' argument that Time directors assumed the *Revlon* duty because the stock exchange agreement would lock up the company by creating a company too large to acquire. Time shareholders would be precluded from realizing a control premium transaction in the future.[210] The result of stripping the stockholders of their only opportunity to receive a premium, argued the plaintiffs, is the same as a transaction that transfers control with no premium, and therefore violates the *Revlon* duty of attaining the highest price available.[211] Chancellor Allen rejected this

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207. *Id.*, slip op. at 59-60, *reprinted in* 15 DEL. J. CORP. L. at 739. *See* Franklin, *supra* note 205, at 29, col. 4 ("Lawyers sympathetic to Time say the idea of control of Time passing to Warner is misconstrued because it will be a new company controlled by a widely dispersed group of public shareholders."); Herzel & Shepro, *supra* note 194, at 33:

> In form, Time was buying Warner, not selling Time, but the original merger agreement could have been considered an agreement to sell Time. Delaware law is still unformed on this important issue. The chancellor respected the legal framework imposed by the original agreement and found that no sale would have taken place in the merger. The main distinction suggested by his opinion appears to be that there is no sale unless a new identifiable group achieves control in the transaction.

But see TW Servs., Inc. v. SWT Acquisition Corp., Nos. 10,427 & 10,298 (consolidated) (Del. Ch. Mar. 2, 1989), *reprinted in* 14 DEL. J. CORP. L. 1169 (1989) (Chancellor Allen argues that both tender offers and mergers result in a change of control).

208. Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990). *See infra* note 219.

209. *Paramount*, Nos. 10,866, 10,670 (consolidated) & 10,935, slip op. at 74-75, *reprinted in* 15 DEL. J. CORP. L. at 747-48.

210. *Id.*, slip op. at 60, *reprinted in* 15 DEL. J. CORP. L. at 740.

211. *Id.*

In their Reply Brief, plaintiffs argued:

> Time will incur at least $8.35 billion in additional senior debt if it acquires Warner. (citations omitted). By incurring this debt, plus $2 billion of subordinated debt that Time anticipates issuing, Time will have exhausted its borrowing capacity. As a result, potential financial and leveraged buyout bidders are precluded from making a bid for Time because such a bid would necessarily have to rely on the borrowing capacity of Time-

argument concluding that while the Time-Warner merger might have made a future takeover less likely because of the large size of the combined company, it did not "legally preclude or impede a future sale or change of control transaction."[212] Moreover, triggering *Revlon* in these circumstances would amount to an "extension of the *Revlon* case beyond sales or other change in control transactions." The original stock exchange agreement was upheld under the business judgment rule.

Having determined that the revised agreement was a reaction to Paramount's offer, the chancellor reviewed the propriety of the stock purchase merger according to *Unocal*. The court held that Paramount's bid constituted a threat to the consummation of the Time-Warner combination—a transaction conceived to further Time's long-term goals while protecting the "Time culture." Time's offer for Warner shares was a reasonable response to these threats. Because there was evidence that the general Time-Warner consolidation had its genesis long before Paramount made a tender offer to Time shareholders, the chancellor perceived the revised agreement as an effort to carry out a bona fide long-term plan more than to serve as an antitakeover devise.[213]

3. The Delaware Supreme Court Decision

The Delaware Supreme Court affirmed the chancery court's ultimate finding that the *Revlon* duty had not been implicated, but took issue with the chancellor's deliberation over whether or not it was permissible for Time directors to protect their long-term profit-making plan when shareholders demonstrate a preference for immediate value maximization.[214]

> Warner to finance the purchase price. Moreover, there are few, if any, strategic corporate buyers that could finance an acquisition of Time-Warner. As a result, consummation of the Time-Warner transaction will—and seems designed to—have the effect of precluding any subsequent acquisition of the combined entity. A $200 bid would require the unprecedented sum of $28 billion and would be the largest acquisition ever concluded.

Plaintiffs' Reply Brief in Support of Their Motion for a Preliminary Injunction at 52, Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990) (citations omitted).

212. *Paramount*, Nos. 10,866, 10,670 (consolidated) & 10,935, slip op. at 61, *reprinted in* 15 DEL. J. CORP. L. at 740.

213. *Id.*, slip op. at 73, *reprinted in* 15 DEL. J. CORP. L. at 747.

214. *Paramount*, 571 A.2d at 1150. Shareholders demonstrate a preference for current value maximization by tendering to an offer.

> [T]he question of "long-term" versus "short-term" values is largely irrelevant because directors, generally, are obligated to chart a course for a corporation which is in its best interests without regard to a fixed investment horizon. [A]bsent a limited set of circumstances as defined under *Revlon*, a board of directors . . . is not under any *per se* duty to maximize shareholder value in the short-term, even in the context of a takeover. . . . Directors are not obligated to abandon a deliberately conceived corporate plan for short-term shareholder profit unless there is clearly no basis to sustain corporate strategy.[215]

The pivotal question according to the Delaware Supreme Court was: "Did Time, by entering into the proposed merger with Warner, put itself up for sale?"[216] The court articulated the limited circumstances that implicate the *Revlon* duty:

> 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 also involving the *break-up* of the company.[217]

The court affirmed Chancellor Allen's conclusion that the original stock exchange agreement did not constitute a change in control, "notwithstanding the unequal share exchange."[218] "However, we premise our rejection of plaintiffs' *Revlon* claim on broader grounds, namely, 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, as was the case in *Revlon*."[219] The court determined that the stock exchange agreement was a strategic decision in the long-term interests of Time shareholders.

The court agreed with Chancellor Allen's determination that the *Revlon* duty is not triggered simply by corporate transactions that

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215. *Id.* at 1150.
216. *Id.*
217. *Id.* (emphasis added, citations omitted).
218. *Id.*
219. *Id.* (emphasis added). The court's avoidance of a "change of control" analysis raises doubt as to whether *Revlon* would trigger were Warner a private company. Consummation of the original merger would have placed 62% of the combined company into the hands of former Warner shareholders. The court's "break-up" test would preclude *Revlon*'s trigger even if Warner were private.

"might be construed as putting a corporation either 'in play' or 'up for sale.'"[220] Time's concern that the "Warner transaction might be viewed as effectively putting Time up for sale" lacked sufficient evidence to invoke the *Revlon* duty.[221]

The court rejected the claim that the revised stock purchase merger constituted an abandonment of Time's strategic plan or made the sale of Time inevitable, reasoning that, though the combined corporation would be large, an acquisition would still be possible.[222] "If . . . the board's reaction to a hostile tender offer is found to constitute only a defensive response and not an abandonment of the corporation's continued existence, *Revlon* duties are not triggered, though *Unocal* duties attach."[223] The stock purchase agreement, because it was "defense-motivated," was reviewed and upheld under the *Unocal* analysis.[224] Applying this analysis, the court first concluded that Time directors reasonably perceived Paramount's offer to be a significant threat to the planned Time-Warner merger and second, that the revised stock purchase transaction was a reasonable response in relation to this threat.[225]

V. EVALUATION

A. *Protection of the Corporate Entity*

In *Paramount* the Delaware Supreme Court cited to the *MacMillan* case as an example of the first set of circumstances that trigger the

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220. *Id.* at 1151.
221. *Id.*
222. *Id.* at 1154-55.
223. *Id.* at 1150-51.
224. *Id.*
225. *Id.* at 1153-55. In upholding the Time Board's transactions under *Unocal*, the court noted that:

> precepts underlying the business judgment rule mitigate against a court's engaging in the process of attempting to appraise and evaluate the relative merits of a long-term versus short-term investment goal for shareholders. . . .
>
> [T]he Time [B]oard reasonably determined that inadequate value was not the only legally cognizable threat that Paramount's all cash, all-shares offer could present. Time's [B]oard concluded that Paramount's eleventh hour offer posed other 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. . . . 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.

Id. at 1153.

Revlon duty.[226] Recall that in *MacMillan II*, management initiated a bidding process to sell the MacMillan company.[227] The ultimate buyer, KKR, was granted a lock-up of substantial MacMillan assets, thereby making the break-up of MacMillan inevitable.[228] The *Revlon* case is similar to *MacMillan II* in that Revlon's buyer, Forstmann, was granted an asset lock-up which rendered the break-up of Revlon inevitable.[229] The court classified the *Revlon* case as an example of the second set of circumstances that trigger the *Revlon* duty since the agreement with Forstmann was made in *response* to Pantry Pride's offer for the Revlon company.[230] The court in *Paramount* concluded, "Thus, in *Revlon* when the board responded to Pantry Pride's offer by contemplating a 'bust-up' sale of assets in a leveraged acquisition, we imposed upon the board a duty to maximize immediate shareholder value and an obligation to auction the company fairly."[231]

The *Paramount* opinion cites to *Ivanhoe* as exemplary of a company not under the *Revlon* duty.[232] Clearly, the Newmont Board's reaction to Ivanhoe's hostile tender offer did not result in the break-up or dissolution of the Newmont company. Recall that Newmont directors declared a dividend which enabled its largest shareholder, Gold Fields, to buy enough of Newmont's outstanding stock to prevent Ivanhoe from gaining control, but not so much as to take absolute majority control out of the open market.[233] Interestingly, the court's finding in *Ivanhoe* that the *Revlon* duty was not triggered seems more supportable under *Paramount*'s corporate *break-up* test than under *Ivanhoe*'s *sale of corporate control* test, since *effective* control was transferred to Newmont management by the board's defensive transactions.[234]

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226. The first set of circumstances referred to is: "[W]hen 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." *Paramount*, 571 A.2d at 1150 (emphasis added).

227. *Mills Acquisition Co.*, 559 A.2d at 1272.

228. *Id.* at 1286.

229. *Revlon*, 506 A.2d at 179.

230. "*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 also involving the breaking-up of the company." *Paramount*, 571 A.2d at 1150 (emphasis added).

231. *Id.*

232. *Id.* "If . . . the board's reaction to a hostile tender offer is found to constitute only a defensive response and not an abandonment of the corporation's continued existence, *Revlon* duties are not triggered, though *Unocal* duties attach." *Id.*

233. *Ivanhoe Partners*, 535 A.2d at 1340.

234. *See supra* text and accompanying notes 125-28.

Under *Paramount*'s *break-up* or dissolution test, the key difference between *Revlon* and *MacMillan*, on the one side, and *Ivanhoe* and *Paramount*, on the other, is that directors of the former companies adopted defensive measures that broke up their corporations, whereas the boards of the latter two corporations maintained the cohesiveness of their corporations while defeating their suitors.[235]

Paramount indicates that the focus of a reviewing court should be on the target's actions as opposed to those of its suitor. This clears up the confusion generated by *Revlon*'s implication that Pantry Pride's tender offer for Revlon shares made the break-up of Revlon inevitable. What made Revlon's break up inevitable was not that Revlon directors decided to *sell* Revlon, but that they decided to sell Revlon to an entity determined to sell the company's assets in order to finance its purchase. Had the Revlon Board chosen to negotiate a sale with a bidder intent on maintaining Revlon as a corporate entity, perhaps the court would not have imposed upon the board the duty to maximize current share value. But the board chose a white knight that would break up Revlon, and in doing so put the company on the auction table.

B. Restoration of a Long-Range Perspective

The *Paramount* decision may put to rest much of the concern generated by *Revlon* that negotiated transactions are no longer safe in the face of a third-party tender offer. *Paramount* brings into focus the substance of a footnote in *MacMillan*, in which the court stated that "not every offer" will force its target to assume the *Revlon* duty: "Circumstances may dictate that an offer be rebuffed, given . . . the alternatives available [and] the company's long-term strategic plans," among other factors.[236] The facts that led to the *Paramount*

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235. *See* Franklin, *supra* note 205, at 29, col. 4:

> When push comes to shove, the court will say this transaction had sufficient continuity. . . . The company was not being liquidated or terminated the way it was in *Revlon* and *MacMillan*. The Time-Warner merger would provide the same management. Probably the court will say Time was not up for sale because [the agreement was] part of a global strategy, a long-term business strategy.

Id. (quoting Professor John C. Coffee, Jr.).

236. *Mills Acquisition Co.*, 559 A.2d at 1285 n.35. *See also* Lipton, *Takeover Bids in the Target's Boardroom: A Response to Professors Easterbrook and Fischel*, 55 N.Y.U. L. REV. 1231 (1980), who advocates the "Just Say No" defense of corporate managers when confronted with a tender offer. Lipton argues that the court should

case emerge as an example of this *MacMillan* passage.[237] That Time directors were able to provide evidence of what they claimed were bona fide long-range goals weighed considerably in Time's favor.[238]

In many respects the *Paramount* opinion reflects the classic conflict between short- versus long-term corporate investment and gain.[239]

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permit a corporate board to maintain defensive mechanisms, in particular the "poison pill," in the face of ostensibly non-threatening overtures such as the all-cash, all-shares tender offer, where the board determines that such an offer is not in the best long-term interests of the shareholders. *Contra* Easterbrook & Fischel, *Auctions and Sunk Costs in Tender Offers*, 35 STAN L. REV. 1 (1982) [hereinafter Easterbrook & Fischel, *Auctions and Sunk Costs*]; Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981) [hereinafter Easterbrook & Fischel, *The Proper Role*], who argue that when a corporation is confronted with a hostile tender offer, management should refrain from taking steps in an attempt to defeat the offer, and instead allow the shareholders to choose; Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, 35 STAN. L. REV. 51 (1982).

237. *See* Franklin, *supra* note 205, at 5, col. 3 ("In the *Time-Warner* case, the experts are focusing on a footnote in the *MacMillan* decision that says not all offers or transactions invoke *Revlon* duties. Any offer may be rebuffed depending on its nature and timing and its effect on the corporation's 'long-term strategic plans.'").

238. *But see* Bruck, *Deal of the Year*, The New Yorker, at 66-89, Jan. 8, 1990 (discussing the key role Steven Ross, chairman and CEO of Warner Communications, Inc., played in consummating the Time/Warner deal and begging the question of whether it would be "Time/Paramount" had Ross been affiliated with Paramount). *See also* Herzel & Shepro, *Delaware Supreme Court Boosts Powers of Takeover Target Boards*, Financial Times, Mar. 22, 1990, at 16 ("anti-takeover changes in state legal rules like this one [the *Paramount* decision] are making hostile acquisitions very difficult. On the other hand, friendly negotiated mergers with a clear business goal should be much easier and less costly to achieve because they will face less competition"); Paley, *supra* note 86, at 44, col. 6 ("The [chancery court] decision in *Time* makes it clear that companies may enter into strategic business combinations without putting themselves into play.").

The question now is, will the courts be able to distinguish legitimate, bona fide long-range corporate goals from defensive fronts?

239. Herzel & Shepro comment on the *Paramount* decision:

> "The court's second main point was to outline the very broad powers of boards of directors in takeover situations—shareholders' desires for short-term profits were not the primary consideration. . . . Very plainly, the court extended the power to corporate target boards, in some circumstances, to reject high premium takeover bids and, when there is more than one bid, to accept a low bid that fits into the board's [long-term] strategy."

Herzel & Shepro, *supra* note 238, at 16. *See also* THE AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS, DISCUSSION DRAFT No. 2, pt. VI, Apr. 20, 1989, at 26, 36:

> [T]he principle . . . that the objective of the corporation is to conduct business activities with a view to enhancing profit . . . does not mean that the objective of the corporation must be to realize profit in the short run. Indeed, the contrary is true: long-run profitability is at the core of the

The debate is not new but has come into focus with the increase of institutional investors and their money managers who generally seek quick gains. Diversified investments ensure that unsuccessful risks will not weigh heavily upon the performance of the total investment fund.[240] Clearly the court has restored protection and thus power to

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> economic objective . . . . Activity that entails a short-run cost to achieve an appropriately greater long-run profit is therefore not a departure from the economic objective . . . .

240. Herzel & Shepro write:

> It is probably true that even if Time's bid had excellent long-term prospects for its shareholders they would prefer the large short-term gains offered by the Paramount bid. From an individual standpoint, they are right—they can invest the cash from the Paramount bid in another business that appears to have good prospects. That is not necessarily true for investors as a whole.
>
> The point can be seen in the case of institutional investors. Because of intense competition for business, institutional money managers need immediate gains and prefer the short-term gains from the Paramount offer. But as a group they are completely diversified. They hold Time, Paramount and Warner stock. If they had been acting together, they might have been better off with the original Time-Warner merger because no new debt would have been created.
>
> This does not explain why the market valued the original Time-Warner combination less than the Paramount bids. The answer appears to be that institutions and the market prefer more debt and large short-term gains, probably because they mistrust how managements use cash and borrowing power.

Herzel & Shepro, *supra* note 194, at 33. Professor Coffee, *supra* note 19, elaborates on this explanation:

> the interests of shareholders and managers are fundamentally in conflict over the issue of risk. . . .
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> . . . .
>
> . . . Put simply, the rational manager has good reason to be risk-adverse, while the fully diversified shareholder has every reason to be risk neutral. [T]his conflict over risk preferences is the strain in the corporate web that best explains the significant disparity between stock and asset values that invites bust-up takeovers.

Id. at 11, 13 (footnotes omitted).

> Modern financial theory assumes that rational shareholders will hold diversified portfolios. Although there is some evidence that individual investors do not in fact hold well-diversified portfolios, this generalization certainly fits institutional investors, who today dominate the marketplace. In any event, it seems clear that investors, whether individual or institutional, are better diversified than managers. Managers are inherently overinvested in the firm they serve . . . .

Id. at 17 (footnotes omitted). "[M]anagers maximize sales or growth, not profits." *Id.* at 20. "[M]anagers seek to build a diversified portfolio within their firm. [E]mpire building may be rational for managers but inefficient for shareholders." *Id.* (footnote

corporate boards of directors to plan and carry out long-range profit-making strategy.[241] Call it a "backlash," but takeovers just are not viewed as favorably as they were a decade or so ago when they were coined the antidote for a self-serving, inefficient and overinsulated American corporate management.[242] Most recently takeovers have

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omitted).

> Once a shareholder has diversified his portfolio, he is in theory largely immune from firm-specific risk, both because no individual stock should have a major impact on his portfolio's performance and because his portfolio will include countercyclical stocks whose price movements will tend to offset each other. [H]e may even behave as a risk preferrer, because he may seek stocks having a high risk level to offset the debt or low-risk components of his portfolio. The manager, however, has no real protection against firm-specific risk and thus will be risk adverse.

Id. at 19.

241. Herzel & Shepro, *supra* note 238, at 16 ("[T]he Delaware Supreme Court's long-awaited opinion on the Time/Paramount takeover battle greatly expanded the powers of directors of target companies."). There is support for this expansion.

> Despite a pending unsolicited tender offer, directors can carry out such business plans to advance the best interests of their shareholders. Otherwise, the making of a tender offer could have the undesirable effect of freezing a target corporation's business. [D]irectors should . . . present evidence . . . that any delay in carrying out the corporation's plans until competition of the tender offer would materially disfavor the long-term interests of its shareholders.

PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (DISCUSSION DRAFT No. 2, APR. 20, 1989), pt. VI, Apr. 20, 1989, at 41.

242. Richard Darman, as Secretary of the Treasury, popularized the term "corpocracy," referring to large corporations as "bloated, risk-adverse, inefficient and unimaginative." *See* Kilborn, *Treasury Official Assails "Inefficient" Big Business*, N.Y. Times, Nov. 8, 1986, at 1, col. 4, *quoted in* Coffee, *supra* note 20, at 34 n.1. Professor Coffee notes: "Similar rhetoric has long been used by the leading financial entrepreneurs who undertake bust-up takeovers. Moreover, their postacquisition behavior has been entirely consistent with their public statements, as they have in fact radically pruned staff size and reduced diversification." *Id.* But Coffee notes the views of other commentators, that "hostile takeovers divert managerial attention, enforce a myopic concentration on the short run, or discourage investment in research and development." *Id.* at 11. Coffee continues:

> Viewed optimistically, the new wave of takeovers represents a mechanism by which shareholders are at last able to counteract management's inherent bias toward risk aversion and excessive earnings retention. In this view, the takeover movement has begun to purge the modern corporation of the organizational slack and high agency costs on which an earlier generation of managerialist critics had focused. Viewed more pessimistically, however, there may be social costs associated with this newfound shareholder power, because society as a whole may share the manager's aversion toward risk or may benefit from his investment in firm-specific human capital.

Id. at 104. Herzel & Shepro write:

> With this [Paramount] judgment the Delaware Supreme Court has moved

been used to break up corporations rather than to improve them as going concerns.[243] The *Paramount* decision may be a reaction to this

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> Delaware much closer to the general anti-takeover sentiment in the US epitomized by new state statutes broadening the powers of target boards of directors to resist takeovers. . . .
>
> In the last 25 years, academic economists have been the intellectual backbone of the takeover movement. They correctly argued that the threat of takeovers was an important discipline on the self-serving behaviour of corporate managers. Recently, some of these economists have begun to have doubts about other effects of takeovers such as a pervasive short-term outlook, too much corporate debt and too many bad acquisitions by bidders.

Herzel & Shepro, *supra* note 238, at 16. *See infra* note 251 (discussing state statutes that broaden the power of target boards to resist takeovers).

243. "We have entered the era of the two-tier, front-end loaded, bootstrap, bust-up, junk-bond takeover," declared Martin Lipton, in 1985. Lipton, *Takeover Abuses Mortgage the Future*, Wall St. J., Apr. 5, 1985, at 16, col. 4. Professor Coffee writes:

> Until recently, takeovers typically involved larger firms digesting small firms, a process that most theorists have assumed was driven by the pursuit of synergistic gains. Lately, however, this dynamic has dramatically reversed itself. [T]he large conglomerate is now the target . . . . The new bidder in turn tends to be a financial entrepreneurs—either a single individual or an ad hoc collection of individuals, smaller entities, and investment banking firms—who intends not to assimilate the target, but to dismantle it. Since 1984, we have entered the era of the "bust-up" takeover—that is, a takeover motivated by the perceived disparity between the target's liquidation and stock market values. A new breed of financial entrepreneur, originally typified by Carl Icahn and [T.] Boone Pickens, but more recently expanded to include major investment banking firms acting for their own account, has appeared on the scene, who essentially arbitrages this difference between stock and asset value by first acquiring control and then partially liquidating the target in order to pay down the acquisition indebtedness. Tactically, it is easy enough to explain how this new era has arrived: new financing techniques—most notable, the appearance of the "junk bond" in late 1983—have vastly extended the capability of the smaller bidder, by allowing it to borrow more and to use the liquidation value of the target as its collateral.

Coffee, *supra* note 20, at 2-4 (footnotes omitted). In a footnote, Coffee elaborates:

> [P]lans to dismantle the target and sell its assets in piecemeal fashion to third parties are often in place and negotiations for resale in progress even before the takeover has succeeded. Similarly, Ted Turner at the outset of his bid for CBS indicated the various CBS properties that he wished to sell. Quaker Oats Company acquired Anderson, Clayton & Company for $812 million in 1986 and then announced that it would retain only one division, the Gaines pet food line, and sell the majority of the assets. As a result, although the bust-up takeover has its precursors and all takeovers threaten job security of the incumbent target management, the distinctive pattern (and underlying financial arrangements) associated with these transactions implies that asset divestitures and substantial layoffs are marginally

recent phenomena: an intention on the part of the court to encourage mergers and acquisitions performed with the goal of maintaining and improving companies in the long-run while constraining the consummation of takeovers done purely for short-term economic gain.[244] The difficulty for courts will lie in determining from the evidence provided whether transactions alleged to be part of a legitimate, bona fide long-range plan for corporate profitability are truly so or just a defensive front used by target directors to "just say no."[245]

The *Revlon* and *Paramount* opinions may reflect an effort on the part of the court to balance power between the inherently adverse interests of shareholders and managers.[246] Theoretically, contemporary shareholders represent a capitalistic, free-market perspective, whereas managers represent a perceived need for market regulation.

From a shareholder perspective, takeovers that break up corporations and sell assets at premium prices promote economic effi-

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more likely.

. . . .

Courts have also recognized the special nature of the bust-up takeover and hinted that they may justify defensive tactics not otherwise appropriate.

Id. at 3-4 n.4 (citations omitted).

244. Discussing typical "raider mentality" with focus on Ronald Perelman (Revlon), James Goldsmith (Grand Union), Carl Icahn (TWA), and Victor Posner (Sharon Steel), David Carey writes:

> Some of the most famous takeover artists have done no better than the CEO's they vilified and ousted. Why? They suck money out of the business rather than put it in. . . . The instincts of a raider are at war with those of a manager. A raider buys companies to take money *out*, not to put it in. He tends to be a short-term strategist who relies too frequently on quick financial solutions to redress long-term failures of leadership. His restorative efforts are often confined to cost cutting, and profits may surge powerfully at first. But the company's health begins to break down from want of reinvestment. [T]he raider's propensity [is] to view acquisitions not as continuing businesses but as crypts for cash, which they liberate for their own enrichment at whatever cost to the company.

Carey, *Can Raiders Run What They Raid?*, FORTUNE, June 4, 1990, at 193.

245. *See supra* note 236 (discussing the "just say no" defense). Herzel & Shepro predict:

> After this [*Paramount*] opinion, target board procedures should become more important than ever. The opinion encourages target boards to make a record showing a pre-existing corporate business plan or that the dissolution or break-up of the company will not be inevitable even in a merger or sale in which the company's shareholders receive cash for all of their stock.

Herzel & Shepro, *supra* note 238, at 16.

246. *See supra* notes 240-44.

ciency and wealth as assets are moved where they are most valued.[247] While management will generally prefer corporate growth through diversification, it may not be synergistic for a corporation to comprise itself of a myriad of diversified endeavors. Bust up takeovers, then, are a remedial devise for economic inefficiency.[248]

But pure economic efficiency may leave much to be desired from a societal perspective, reflected in externalities such as unemployment.[249] There is a perception that the economic and social

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247. Dynamics Corp. of Am. v. CTS Corp., 794 F.2d 250, 253 (7th Cir. 1986), *rev'd on other grounds*, 481 U.S. 69 (1987) (stating that, through tender offers, "the market for corporate control will be kept fluid and corporate assets will be transferred, with a minimum of friction, to those who value them the most, as measured by the prices they offer.")

Easterbrook and Fischel believe that target management should remain passive when faced with a tender offer. This will minimize the cost of takeover bids and maximize shareholder wealth. The authors state that "[l]egal rules allowing the target's management to engage in defensive tactics in response to a tender offer decrease shareholder welfare. The detriment to shareholders is fairly clear where defensive tactics result in a defeat of a takeover, causing shareholders to lose the tender premium." *See* Easterbrook & Fischel, *The Proper Role*, *supra* note 236, at 1164.

Another view is that, in responding to a tender offer, target management should encourage an auction for its shares. *See* Bebchuck, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028, 1030 (1982); Gilson, *supra* note 236; Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 868-75 (1981) (arguing that faciltating an auction is beneficial to shareholders).

248. *See generally* R. GILSON, THE LAW AND FINANCE OF CORPORATE ACQUISITIONS (Supp. 1990).

249. In discussing the "social accounting of who wins and who looses under the new takeover regime," Professor Coffee notes that "[s]hareholder wealth and social wealth are not synonymous. The former can be enhanced in ways that do no increase, and may even decrease, the latter." Coffee, *supra* note 20, at 104. Employees, creditors and the state and local communities are the "ultimate insurers of residual corporate liabilities," states Coffee. Coffee continues,

> At a minimum, the state's welfare rolls increase when corporations fail, and often the state winds up partially compensating tort creditors. . . . Also, the state's role has low visibility because the state does not in any formal sense guarantee the obligations of the firm; rather, it absorbs indirectly many of the losses initially experienced by the other constituencies that surround the firm. Axiomatically, if plants are closed and workers and managers are laid off in the aftermath of either a takeover or a defensive tactic that increases corporate leverage, much of the resulting costs will fall on the state, which typically will be required to pay increased welfare benefits and make other transfer payments. In the case of local communities, there may also be extensive firm-specific investments that the community has funded to create the infrastructure of social services

goals we as a nation embrace would not be adequately provided for were the market permitted to operate with absolute freedom. We thus see an effort by the courts,[250] and by state legislatures,[251] to strike a balance between freedom and regulation.

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that surround a major plant or corporate headquarters.

Coffee, *supra* note 20, at 72.

> Every corporate takeover necessarily involves a change in control and a sale. Nearly every takeover also ultimately involves some amount of dislocation (e.g., corporate staff consolidation, reductions implemented by attrition or layoffs, plant closings, and some divestitures), but the enterprise remains more or less intact. However, as twice noted by the *Revlon* court, when a fact pattern involves a junk bond bust up of a company, then the directors have no where else to measure their performance of their duties than the bank accounts of the shareholders. They have no corporate entity to protect because the entity will cease to exist.

Reder, *supra* note 21, at 281. *But see supra* note 247 (discussing the role takeovers play in economic efficiency).

250. The Delaware Supreme Court has recognized as proper consideration of non-stockholder corporate constituencies when not under the *Revlon* duty to auction:

> 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. This entails an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise. Examples of such concerns may include: inadequacy of the price offered, nature and timing of the offer, questions of illegality, *the impact on "constituencies" other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)*, the risk of non-consummation, and the quality of securities being offered in exchange.

Unocal, 493 A.2d at 955 (emphasis added) (citation omitted).

251. Herzel & Shepro comment:

> If Time were incorporated under another state's law, the decision might have been easier. New York now has a statute allowing directors of a target corporation to consider the long-term effect of a takeover on shareholders and the company. Other new state statutes give target directors additional extensive powers to consider the effects of takeovers on employees, suppliers, customers and communities.

Herzel & Shepro, *supra* note 194, at 33. PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (DISCUSSION DRAFT NO. 2, APR. 20, 1989), at 34. "In looking to the long-term interests of the shareholders, directors may consider the fact that the long-term well-being of the shareholders requires stable relationships with suppliers and customers and a cooperative relationship with the communities in which the corporation does business." *Id.* at 35-36. "Toward this end, states have adopted statutes authorizing board directors to consider the interests of employees, suppliers, customers, and the local community." *See* ARIZ. REV. STAT. ANN. § 10-1201-A (1956 & 1990); IDAHO CODE § 36-1702 (1990); IND. CODE ANN. § 23-1-35-1(g) (Burns 1990); KY. REV. STAT. ANN. § 271A.397(4)(d) (Baldwin 1989); ME. REV. STAT. ANN. tit. 13-A, § 716 (1989); MINN. STAT. ANN. § 302A.251, subd. 5 (West 1990); MO. ANN. STAT. § 351.347 (Vernon 1990); NEB. REV. STAT. § 21-2035 (1943); N.M. STAT. ANN. § 53-11-35 (1989); N.Y. BUS. CORP. LAW § 717(b) (McKinney 1990); OHIO REV. CODE ANN. § 1701.59(e) (1990); 15 PA.

C. *Triggering the* Revlon *Duty After the* Paramount *Decision*

What *Paramount* stands for is a policy against corporate break ups,[252] arguably a message the court intended to convey in *Revlon*, but was misconstrued or purposefully avoided for practical reasons by subsequent courts.[253] Perhaps the Delaware Court of Chancery limited its *Revlon* inquiry to the *sale* or *transfer of control* because of the relative ease in application when compared to a test that would require courts to determine whether and at what stage of the game the break up of a company is "inevitable."[254] But this is what the Delaware Supreme Court has called for in the *Paramount* opinion.

Paramount holds that, aside from the isolated case where a corporate board actually initiates a bidding process to sell the corporation, the *Revlon* duty will trigger only when a board of directors either initiates a transaction *or* responds to an offer in such a way as to cause a break up or dissolution of its corporation.[255] Inherent

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CONS. STAT. ANN. § 511 (Purdon 1990); WIS. STAT. ANN. § 180.305 (West 1989).

> [W]hen the issue of risk is at center stage, a closer identity of interests may exist among managers, employees, and the community of unrepresented interests that surround the corporation and depend upon its solvency. [These constituencies] share the common circumstances of a nondiversifiable investment in the corporation that makes them risk adverse. . . . On the topic of takovers, it may be that the more natural alliance today is between managers and those who fear the social dislocations and other potential externalities that the takeover movement can bring about. . . . Thus, the central question from a public law perspective is how much [managerial] accountability is too much.

Coffee, *supra* note 20, at 108-09.

252. Reder, *supra* note 21, at 275.

253. *See also* Herzel & Shepro, *supra* note 238, at 16.

> The court's answer was [that] there was no 'substantial evidence to conlude that Time's [B]oard, in negotiating with Warner, made the dissolution or break-up of the corporate entity inevitable.
>
> This pronouncement is an important step in clearing up some of the greater ambiguities on the duty to auction that the court left behind in its 1986 opinion in *Revlon v. MacAndrews & Forbes Holdings Inc.*
>
> None the less, the opinion leaves room for new litigation; such as, when is the dissolution or break-up of the corporate entity inevitable?

Id.

254. *See* Reder, *supra* note 21, at 281 (suggesting that courts have made their evaluations based on "sale" because of its less subjective nature).

255. *Paramount*, 571 A.2d at 1150. *See supra* note 222 and accompanying text. Only under these "limited circumstances" will a board of directors assume the *Revlon* duty. *Id. See also* Freund & Ward, *Mergers and Acquisitions: Whats "In," "Out" in Takeovers in Wake of* Paramount v. Time, Nat'l L.J., Mar. 26, 1990, at 23, col. 2.

> The company most likely to end up in the *Revlon* soup is one which, like

in a transaction that results in the break up of a corporation is the abandonment of long-term strategy. That the Delaware Supreme Court chose to review the Time Board's transactions under a break-up analysis perhaps undermines the triggering effect of a mere sale or transfer of control.[256]

Determining when the break up of a company is inevitable will be no easy task and may require the courts to engage in "line-drawing."[257] For instance, the court may have to determine whether the sale of *one* division of a corporation—or *four* divisions for that matter—changes the nature of the corporate entity to such a degree that it constitutes a break up or dissolution.[258]

> Revlon itself, would "abandon its long-term strategy and seek an alternative transaction . . . involving the break[ ]up of the company"—a course of action which is so far "out" as to be barely discernible on the horizon, because it may be just about the only thing that could involuntarily trigger an auction.

256. In discussing what triggers *Revlon* after the *Paramount* decision, Professor Gilson comments:

> The problem of the coherence of a dissolution or break-up standard remains. . . . Suppose . . . that Time attempted a management buyout which did not contemplate the dissolution or break-up of the company. The Supreme Court's opinion in *Time suggests that Revlon would not be triggered because the buyout would not contemplate the company's dissolution or break-up. . . .* The conceptual problem may be only that the Supreme Court is reluctant to determine *whether Revlon is really triggered by the sale of the company. . . .* The effect of the Supreme Court's focus on dissolution or break-up leaves the authority to effect a transfer of control in the board, subject only to *Unocal* review if a competing bid arises.

GILSON, *supra* note 248, at 415-16 (emphasis added). *See* Freund & Ward, *supra* note 255, at 23, col. 2:

> Auctions are out. Some say that the Delaware courts have been chipping away at *Revlon* almost since it first came down; now, *Time* [*Paramount*] slips a safety latch onto the *Revlon* trigger. According to the court, corporate reorganizations that don't bust-up the company don't give rise to *Revlon* duties to maximize immediate shareholder value. Such duties arise only with "an active bidding process seeking to sell" the company or an effort "to effect a business reorganization involving a clear break-up of the company."

Id. (quoting *Paramount*, 571 A.2d at 1150).

257. Reder, *supra* note 21, at 281.

258. *See id.* at 81-82 ("[I]f only one division of a company is to be sold off to finance part of the purchase price, is that a 'break-up'? [D]efining a break-up may make that test merely an academic's delight." Reder concludes, "Can one really blame the chancellor for interpreting *Revlon* to apply simply to sales or changes in control?"). Reder, *supra* note 21, at 81.

See, e.g., Tomczak v. Morton Thiokol, Inc., No. 7861 (Del. Ch. Apr. 5, 1990). Morton Thiokol, Inc. (Thiokol) operated four major businesses: Aerospace, Specialty

VI. CONCLUSION

The *Revlon* case involved a contest for control of the Revlon company, with all of its bidders intending to follow the purchase with a sale of Revlon's divisions. Revlon's Board of Directors assumed the duty to immediately maximize the value of Revlon when it agreed to sell the corporation to be broken up. But due to an ambiguous opinion in which the court implied that Revlon's suitor, Pantry Pride, caused the inevitable break up of Revlon, the case suggested that a board of directors might involuntarily assume the *Revlon* duty where it has no intention of selling and breaking up the company. This raised concerns about the ability of directors to carry out a long-range investment strategy when shareholders were faced with an offer to sell.

Perhaps uncomfortable with having to determine on a case-by-case basis when the break up of a company becomes inevitable, courts interpreted *Revlon* as having held that the duty to maximize current share value attaches when corporate control is to be sold. This *sale of corporate control* test was soon expanded to include *transfers of corporate control*, in order to capture restructurings which confer *effective* control to management without requiring public shareholders to dispose of their equity, as they do in a sale.

Chemicals, Salt, and Household Products. The Specialty Chemicals and Aeropsace became the chief businesses, setting the corporation "in a new direction, away from consumer products." *Id.*, slip op. at 5. The Household Products business lagged behind. Although Thiokol's Board of Directors considered divesting this business since it lacked the "strategic fit" with the other businesses, a decision to divest was put on hold since profit was still being made from the business. Interest in the Household Products business from companies such as Dow Chemical (Dow) was rebuffed by Thiokol directors, who were interested in "growth" by pursuing a "possible swap" of the Household Chemical business for a business "that would strengthen Morton Thiokol's other businesses . . . ." *Id.*, slip op. at 6. When Dow began to accumulate Thiokol's stock, the Thiokol Board agreed to sell the Household Products business to Dow in exchange for both cash and for Dow's shares of Thiokol. Plaintiffs Thiokol-shareholders challenged the sale in the Delaware Chancery Court arguing, among other things, that it triggered the *Revlon* duty to sell the corporate asset to the highest bidder. The court held that the sale of Household Products did not trigger *Revlon* as it "represented the sale of only one of four divisions of Morton Thiokol" which was not a sale of the entire company nor did it effect a business reorganization involving a break-up of the company. *Id.*, slip op. at 38. "[T]he sale [was] consistent with the company's long-term plans. Consequently, the sale of Texize [the Household Products business] could not trigger any *Revlon* duties." *Id.* (emphasis added). "The sale of Texize also gave Morton the opportunity to use some of the cash received in the sale of Texize to purchase Bee Chemical Co., whose specialty chemical business was a better 'strategic fit' with Morton's other divisions than was Texize's household products business." *Id.*, slip op. at 25.

The *Paramount* decision finally resolves the unsettling implication of *Revlon* that a board of directors can be forced into assuming the *Revlon* duty. After *Paramount*, a board of directors will be charged with the *Revlon* duty only in very limited circumstances. Other than when a board initiates a bidding process seeking to sell itself, a board will be charged with the *Revlon* duty only if it takes action that makes the *break-up* or dissolution of the corporate entity inevitable. Inherent in such a transaction is the abandonment of long-term strategy. The *Paramount* decision restores to corporate management the ability to plan and carryout bona fide, long-range corporate goals. The difficulty for courts will lie in distinguishing measures taken to protect *bona fide* long-range goals from measures taken primarily to thwart a takeover.

Whether the Delaware Court of Chancery will continue to focus its *Revlon* analysis on the sale or transfer of corporate control is an issue which corporate planners will soon want resolved. The Delaware Supreme Court, however, has made clear that the primary concern should be with transactions that *break up* corporations.

Portia Policastro